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# Supreme Court of the United States

OCTOBER TERM, 1961

## No. 255

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UNITED STATES, PETITIONER

*vs.*

DON GILMORE, ET AL.

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ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF CLAIMS

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[fol. A]

# IN THE UNITED STATES COURT OF CLAIMS

No. 374-58

DON GILMORE and SUE GILMORE, PLAINTIFFS

v.

UNITED STATES OF AMERICA, DEFENDANT

PETITION—Filed August 19, 1958

*To the Honorable, the United States Court of Claims:*

1. Plaintiffs are husband and wife, citizens and residents of California. They were married prior to December 31, 1955, and have remained husband and wife thereafter.

2. On or before March 15, 1954, plaintiff Don Gilmore filed his individual income tax return for the taxable year 1953 with the District Director of Internal Revenue at San Francisco, California, showing a tax liability of $18,209.86, and paid said tax to defendant.

3. On or before April 15, 1955, plaintiff Don Gilmore filed his individual income tax return for the taxable year 1954 with the District Director of Internal Revenue at San Francisco, California, showing a tax liability of $7,097.83, and paid said tax to defendant.

4. On or before April 15, 1956, plaintiffs filed their joint income tax return for the taxable year 1955 with the District Director of Internal Revenue at San Francisco, California, showing a tax liability of $10,137.52, and paid said tax to defendant.

[fol. B] 5. On or about January 8, 1958, the Commissioner of Internal Revenue assessed deficiencies in income taxes against plaintiff Don Gilmore as follows:

| *Taxable Year* | *Taxes* | *Interest* | *Total* |
|---|---|---|---|
| 1953 | $18,883.26 | $4,154.32 | $23,037.58 |
| 1954 | $ 3,762.21 | $ 583.12 | $ 4,345.33 |

6. Plaintiff Don Gilmore paid all of said deficiency assessments of income taxes to defendant on November 15, 1957, and paid all of said deficiency assessments of interest to defendant on November 27, 1957.

7. Of the aforesaid income taxes and interest, the following amounts were erroneously and illegally assessed and collected:

| *Taxpayer* | *Taxable Year* | *Amount* |
|---|---|---|
| Don Gilmore | 1953 | $29,960.08 |
| Don Gilmore | 1954 | $ 4,345.33 |
| Don and Sue Gilmore | 1955 | $ 8,082.36 |
| | | $42,387.77 |

8. On February 11, 1958, plaintiffs filed their respective claims for refund of the aforesaid overpayments of income taxes with the District Director of Internal Revenue at San Francisco, California, in the form of Exhibits A, B and C attached to this complaint, which are incorporated herein by reference. More than six months have elapsed since the filing of said claims, and defendant has not allowed them, nor has any part thereof been paid to plaintiffs.

9. This court has jurisdiction of these claims under § 1491, Title 28, U. S. Code.

10. No other action has been taken or had on the aforesaid claims in Congress or by any of the Departments of defendant or in any other judicial proceeding. Plaintiffs are the owners of said claims and have made no assignment or transfer thereof, or of any portion or part thereof or interest therein, and they are respectively entitled to the full amounts claimed in said claims.

[fol. C] WHEREFORE, plaintiffs pray that this court render its judgment against defendant, for plaintiff Don Gilmore in the amount of $34,305.41, and for both plaintiffs in the amount of $8,082.36, all with interest as provided by law, and for plaintiffs' costs.

Respectfully submitted,

/s/ Eli Freed
ELI FREED
1069 Mills Building
San Francisco 4, California
DOuglas 2-3502

*Attorneys for Plaintiffs.*

FREED & FREED
1069 Mills Building
San Francisco 4, California
*Of Counsel.*

[fol. D] **EXHIBIT A TO PETITION**

FORM 843
REV. JAN. 1955

U. S. TREASURY DEPARTMENT — INTERNAL REVENUE SERVICE

# CLAIM

TO BE FILED WITH THE DISTRICT DIRECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

District Director's Stamp (Date received)

RECEIVED
FEB 11 1958
Dist Director
Int Rev
San Francisco
(34)

The District Director will indicate in the block below the kind of claim filed and fill in, where required.

X Refund of Taxes Illegally, Erroneously, or Excessively Collected.

Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.

Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

PLEASE TYPE OR PRINT PLAINLY

Name of taxpayer or purchaser of stamps
Don Gilmore

Number and street
12 Crest Road

City, town, postal zone, State
Belvedere, California

1. District in which return (if any) was filed
San Francisco, California

2. Name and address shown on return, if different from above
645 Watkins Street, Hayward, California

3. Period - If for tax reported on annual basis, prepare separate form for each taxable year
From January 1 1953. To December 31 1953

4. Kind of tax
Income

5. Amount of assessment
$6,366.44

Dates of payment
Various dates during taxable year, and Nov. 15 & 27, 1957

6. Date stamps were purchased from the Government
-------

7. Amount to be refunded
$29,960.08 with int., as plus such addi-

8. Amount to be abated (not applicable to income, estate, or gift taxes)
tional amount as may be found due to taxpayer

9. The claimant believes that this claim should be allowed for the following reasons

See attached sheet

Use reverse if space is not sufficient.

I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

Signed: Don Gilmore

Dated 2/6, 1958

## INSTRUCTIONS

1. The claim must set forth in detail each ground upon which it is made and facts sufficient to apprise the Commissioner of the exact basis thereof.

2. If a joint income tax return was filed for the year for which this claim is filed, both husband and wife must sign this claim even though only one had income.

3. Whenever it is necessary to have the claim executed by an agent on behalf of the taxpayer, an authenticated copy of the document specifically authorizing such agent to sign the claim on behalf of the taxpayer shall accompany the claim.

4. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

5. Where the taxpayer is a corporation, the claim will be signed with the corporate name, followed by the signature and title of the officer having authority to sign for the corporation.

[fol. E]

DON.GILMORE - FORM [illegible] - TAX YEAR [illegible]

Line [illegible]: Reasons for allowing the claim.

1. [illegible]% of expenses for legal fees of taxpayer's attorneys, and of other costs in divorce proceedings (except fees paid to attorneys for Dixie Gilmore), were incurred and paid during the taxable year for the conservation of the taxpayer's income-producing property. They are therefore deductible expenses. They were erroneously treated by the Commissioner as personal expenditures.

2. The Commissioner has erroneously credited to Dixie Gilmore, and refused to credit to the taxpayer, amounts of income tax withheld from the taxpayer's salary by his employer and which were deposited by taxpayer's employer to the taxpayer's credit with the District Director of Internal Revenue.

3. The Commissioner has erroneously allocated to Dixie Gilmore, and refused to allow as a deduction from the taxpayer's gross income, income taxes paid to the State of California by the taxpayer for his account and not for that of Dixie Gilmore, in the amount of $1,8[illegible].17.

4. The Commissioner has erroneously credited to Dixie Gilmore, and disallowed as an expense of the taxpayer, amounts of unemployment insurance tax paid for the taxpayer's account to the State of California. These amounts were expenses of the taxpayer and were not paid for or expenses of Dixie Gilmore.

[fol. F] EXHIBIT B TO PETITION

| FORM 843 REV. JAN. 1955 | U. S. TREASURY DEPARTMENT - INTERNAL REVENUE SERVICE<br>**CLAIM**<br>TO BE FILED WITH THE DISTRICT DIRECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID | District Director's Stamp (Date received)<br>RECEIVED<br>Dist Director<br>Int Rev<br>San Francisco<br>(34)<br>Feb 11 1958 |
|---|---|---|

The District Director will indicate in the block below the kind of claim filed, and fill in, where required.

[X] Refund of Taxes Illegally, Erroneously, or Excessively Collected.

[ ] Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.

[ ] Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

PLEASE TYPE OR PRINT PLAINLY

Name of taxpayer or purchaser of stamps: Don Gilmore

Number and street: 12 Crest Road

City, town, postal zone, State: Belvedere, California

| 1. District in which return (if any) was filed | 2. Name and address shown on return, if different from above |
|---|---|
| San Francisco, California | 645 Watkins Street, Hayward, California |

| 3. Period - If for tax reported on annual basis, prepare separate form for each taxable year | 4. Kind of tax |
|---|---|
| From January 1 1954 To December 31 1954 | Income |

| 5. Amount of assessment | Dates of payment | 6. Amount to be abated (not applicable to income, estate, or gift taxes) |
|---|---|---|
| $ 11,443.16 | Various dates during taxable year and November 15, 1957 and November 27, 1957 | |

| 8. Date stamps were purchased from the Government | 7. Amount to be refunded | |
|---|---|---|
| | $4,345.33 with int., plus such additional amount as may be found due to taxpayer | |

9. The claimant believes that this claim should be allowed for the following reasons:

80% of expenses for legal fees of taxpayer's attorneys, and of other costs in divorce proceedings, were incurred for the conservation of the taxpayer's income-producing property. They are therefore deductible. They were erroneously treated by the Commissioner as personal expenditures.

Use reverse if space is not sufficient.

I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

Signed [signature]
Don Gilmore

Dated [illegible], 19[illegible]

INSTRUCTIONS

1. The claim must set forth in detail each ground upon which it is made and facts sufficient to apprise the Commissioner of the exact basis thereof.

2. If a joint income tax return was filed for the year for which this claim is filed, both husband and wife must sign this claim even though only one had income.

3. Whenever it is necessary to have the claim executed by an agent on behalf of the taxpayer, an authenticated copy of the document specifically authorizing such agent to sign the claim on behalf of the taxpayer shall accompany the claim.

4. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

5. Where the taxpayer is a corporation, the claim will be signed with the corporate name, followed by the signature and title of the officer having authority to sign for the corporation.

[fol. G] EXHIBIT C TO PETITION

Form 843
Rev. Jan. 1955

DEPARTMENT OF THE TREASURY — INTERNAL REVENUE SERVICE

# CLAIM

TO BE FILED WITH THE DISTRICT DIRECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

(District Director's Stamp (Date received))

RECEIVED
FEB 11 1958
DIST DIRECTOR
INT REV
SAN FRANCISCO
(34)

The District Director will indicate in the block below the kind of claim, and fill in, where required.

X Refund of Taxes Illegally, Erroneously, or Excessively Collected

Refund of Amount Paid for Stamps Unused, or Used in Error or Excess

Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

PLEASE TYPE OR PRINT PLAINLY

Name of taxpayer or purchaser of stamps
Don and Sue Gilmore

Number and street
12 Crest Road

City, town, postal zone, and State
Belvedere, California

1. District in which return (if any) was filed
San Francisco, California

2. Name and address shown on return if different from above
645 Watkins Street, Hayward, California

3. Period - If tax reported on annual basis, prepare separate form for each taxable year
From January 1 1955 To December 31 1955

4. Kind of tax
Income

5. Amount of assessment
$10,137.52

Dates of payment
Various dates during taxable year.

7. Date stamps were purchased from the Government
---

8. Amount to be refunded
$8,082.36 with int., x plus such addi-

9. Amount to be abated (not applicable to income, estate, or gift taxes)
tional amt. as may be found x due to taxpayers

9. The claimant believes that this claim should be allowed for the following reasons: Don Gilmore was previously married to Dixie Gilmore, and this marriage was dissolved by a final decree of divorce effective Oct. 25, 1955. Wages, etc. paid to Don Gilmore between Jan. 1 and Oct. 25, 1955, were community income of Don Gilmore and Dixie Gilmore, of which one-half is taxable to Dixie Gilmore. The present taxpayers, Don and Sue Gilmore, erroneously reported all of such income as their community income, and are filing this claim to eliminate from their gross income the portion thereof which is taxable to Dixie Gilmore. (Computation attached.)

Use reverse if space is not sufficient.

I declare under the penalties of perjury that this claim, including any accompanying schedules and statements, has been examined by me, and to the best of my knowledge and belief is true and correct.

Signed Don Gilmore
Sue Gilmore

Dated 1958

## INSTRUCTIONS

1. The claim must set forth in detail each ground upon which it is made and facts sufficient to apprise the Commissioner of the exact basis thereof.

2. If a joint income tax return was filed for the year for which this claim is filed, both husband and wife must sign this claim even though only one had income.

3. Whenever it is necessary to have the claim executed by an agent in behalf of the taxpayer, an authenticated copy of the document specifically authorizing such agent to sign the claim on behalf of the taxpayer shall accompany the claim.

4. If a return is filed by an individual, and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be furnished with the claim to show the authority of the executor, administrator or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

5. Where the taxpayer is a corporation, the claim will be signed with the corporate name, followed by the signature and title of the officer having authority to sign for the corporation.

[fol. H]

Don Gilmore
ors: Fulton St, Hayward California

1955

Income from Salaries

| Employer | Total Salary | Total Salary not withheld |
|---|---|---|
| Don Gilmore San Francisco | 20,583.29 | 7,583.29 |
| Don Gilmore, Hayward | 10,800.00 | 6,120.00 |
| Don Gilmore, Riverside | 3,600.00 | 3,600.00 |
| Excess F.I.C.A. Tax | | 168.00 |
| | 34,983.29 | 17,471.29 |

| | Total | Salary prior to 10-25-55 | Salary after 10-25-55 |
|---|---|---|---|
| Don Gilmore San Francisco | 20,583.29 | 20,583.29 | — |
| Don Gilmore, Hayward | 10,800.00 | 7,729.03 | 3,070.97 |
| Don Gilmore, Riverside | 3,600.00 | 2,600.00 | 1,000.00 |
| | 34,983.29 | 30,912.32 | 4,070.97 |

½ to wife Gilmore *

Add
Total to Don Gilmore

* Final decree of divorce from Doris Gilmore, former spouse, was effective Oct. 25, 1955

[fol. 4] IN THE
UNITED STATES COURT OF CLAIMS

[Title omitted]

ANSWER—Filed October 17, 1958

The defendant, the United States of America, by its attorney, Charles K. Rice, Assistant Attorney General, for its answer to the petition filed herein, admits, denies and alleges as follows:

1. Admits the allegations of paragraph 1.

2. Admits that on March 15, 1954, plaintiff Don Gilmore filed with the District Director at San Francisco an individual income tax return for 1953 showing a tax of $18,209.86, and that with the return he made a tax payment of $3,566.86. Defendant also admits that on the return he claimed a withholding credit for the balance of the tax shown to be due. Defendant denies the remaining allegations of paragraph 2.

[fol. 5] 3. Admits the allegations of paragraph 3.

4. Admits that on April 15, 1956, plaintiffs filed with the District Director at San Francisco a joint income tax return for 1955 showing a tax of $10,137.52 and claiming a withholding credit and estimated tax payments totaling $22,203.21. Defendant denies the remaining allegations of paragraph 4.

5-6. Admits the allegations of paragraphs 5 and 6, except defendant alleges that assessed deficiencies were paid on January 30, 1958, instead of November 15, 1957, as alleged in paragraph 6.

7. Denies the allegations of paragraph 7.

8. Admits the allegations of paragraph 8, but denies all statements made in the claims for refund not otherwise expressly admitted herein, and denies there were any overpayments of tax.

9-10. Admits the allegations of paragraph 9 and 10, but denies that defendant is indebted to either or both plaintiffs in any amount.

WHEREFORE, defendant having fully answered plaintiffs' petition prays that they take nothing in this suit, that the petition be dismissed, and that defendant be allowed its costs herein.

CHARLES K. RICE,
*Assistant Attorney General*

THEODORE D. PEYSER,
*Attorney.*

[fol. K] IN THE
UNITED STATES COURT OF CLAIMS

No. 374-58

DON GILMORE and SUE GILMORE, PLAINTIFFS

THE UNITED STATES, DEFENDANT

**TRANSCRIPT OF PROCEEDINGS OF OCTOBER 26-27, 1959**

San Francisco, California

• • • •

Present:

Honorable Wilson Cowen, Commissioner

APPEARANCES

Eli Freed, Esquire, and Kurt W. Melchior, Esquire, Counsel for Plaintiffs

Benjamin H. Pester, Esquire, Counsel for Defendant

• • • •

[fol. 1] Monday, October 26, 1959—10:00 A.M.

Testimony for Plaintiffs

The parties met, pursuant to notice of the Commissioner, at the time above stated, in Room 59, Federal Office Building, San Francisco, California.

Present: Honorable Wilson Cowen, Commissioner; Eli Freed, Esquire, and Kurt W. Melchior, Esquire, counsel for plaintiffs; and Benjamin H. Pester, Esquire, counsel for defendant.

Mr. Holmes Christian, a Certified Shorthand Reporter, was thereupon sworn by the Commissioner to well and truly take down and transcribe the questions propounded to and the answers given by the witnesses, and to do all other things required of him by the Commissioner.

Pursuant to the order of reference by the Honorable, the United States Court of Claims, in the above-entitled

cause, testimony on behalf of the plaintiffs was taken as follows:

[fols. 2-3]

[fol. 4] STATEMENT BY MR. FREED

MR. FREED: Your Honor, I think that since the Petition and the Answer don't shed much light on the story, it might be appropriate for me to briefly indicate and outline just what this is about.

THE COMMISSIONER: Yes. I read your claims for [fol. 5] refund. They are considerably more helpful to show what your claim really is, Mr. Freed, but you might make a brief statement to show specifically what you consider the issue here to be.

MR. FREED: We are in California, and in California we have our peculiar Community Property rules, which are so much unlike that of rules pertaining to income and property of other states. I think I might dwell on that.

THE COMMISSIONER: Are they similar to those of my home state of Texas? If they are, I know a little bit about the Community Property law.

MR. FREED: That is very fortunate. They are somewhat similar, but I don't know in which respects they may differ.

The petitioner here and Dixie Gilmore were married, and we have stipulated on that, in Nevada on March 2nd, 1946. That was just the place of marriage. They were actually thereafter residents of California.

Mr. Gilmore, before his marriage, was an automobile dealer, and after his marriage continued to be in that business. He had three places of business, and I should mention the fact that these three places of business were all operated as separate corporations. One place of business was in San Francisco, known as Don Gilmore, San Francisco, a Chevrolet dealership, a California corporation. There was another dealership in Hayward, which is about 20 miles or so from here, as you probably know, Don Gilmore, Hayward, a separate corporation. That was a Chevrolet dealership too. There was another

[fol. 6] dealership in Riverside, not far from Los Angeles, which is a Pontiac dealership.

Mr. Gilmore owned all of the stock of the corporation which owned and operated the Chevrolet dealership in San Francisco. He owned 60% of the issued stock of the corporation which operated the Chevrolet dealership in Hayward. He owned somewhat in excess of 70% of the stock of the corporation which owned and operated the Pontiac dealership in Riverside.

In 1952 Mr. Gilmore's wife, Dixie Gilmore, after that period of marriage, about six years, while they were living together in Belvedere, across the Bay, filed a complaint for divorce against Don Gilmore on the grounds of extreme cruelty.

Several months later she amended that complaint to add an additional ground for divorce, namely, adultery.

Under the California rules, all property acquired by husband and wife after marriage is presumed to be community property. However, all property owned by the husband or the wife before marriage and all rents, issues and profits thereof after marriage continue to be separate property. Generally speaking, all income produced by either spouse as a result of their efforts, their work—"efforts" may be intellectual or physical—is generally speaking community income, and in California we have the peculiar situation which often exists that when the husband expends efforts in reference to property which he owns before marriage, separate property, there often accrues or accumulates or is added to that separate [fol. 7] property community property.

After a period of marriage there often exists the situation where property can be partly separate and partly community, unlike in other states. Usually it is regarded as an encumbrance on separate property. Here they have the characteristics of both, separate and community.

In a divorce case on the grounds of adultery or extreme cruelty, or both, as was the situation here, under our California rules the Court in dissolving the marriage is also required to dissolve the community property, partition it or dissolve it, and is required to give more than 50% of the community property to the innocent party.

In this Gilmore case that was one of the considerations; namely, if one of the spouses was declared to be innocent—and I might mention that under our rules the Court has the power to grant both parties a divorce, either or both, and in which case, if they both get the divorce the community is divided equally, but otherwise the innocent party gets more than 50%, is entitled to more than 50% of the community property.

I might, for the purpose of this, say that all of the income-producing property that existed in the marriage of Don Gilmore and Dixie Gilmore consisted of the investments in these three automobile dealerships, and—

THE COMMISSIONER: Stock ownership?

MR. FREED: Stock ownership, yes. The other in- [fol. 8] come—that is the only income-producing property—the community income in this situation was realized by Don Gilmore from the salaries which he received for his services from the three corporations.

THE COMMISSIONER: He was an officer of all three?

MR. FREED: President and managing officer of all three.

There is some slight income that will be referred to in a stipulation which we expect to file here. It is very small, and I think that it is not an exaggeration to say that all of the income-producing property was the investments in those three corporations.

The claim that was made by Dixie Gilmore, as will appear in the testimony, was that the investments of Don Gilmore in these three automobile dealerships had appreciated, had grown very substantially in value, from the time of marriage to the time of the filing of the complaint. I think it was an appreciation in the neighborhood of about $600,000, and the claim was made by her, as I understand it, that she was entitled to all, or in any event at least one-half, of that interest, and the investments in those three corporations.

That was denied and resisted by Don Gilmore, who, on the other hand, claimed that there was no community property whatsoever in the marriage.

I might mention parenthetically also that we have the rule in California that with reference to all marital ex-

penditures, it is presumed the community property was [fol. 9] used first for all of those expenditures.

As I was saying, Don Gilmore claimed that the community was very substantially overdrawn; that the expenditures made by him and by his wife in the marriage far exceeded all of the community income that was realized during the marriage, so that there was no community property whatsoever left.

Dixie Gilmore, on the other hand, claimed that a rule should be applied that would result in holding that all of that appreciation, or at least one half, was community; the rule being that when there is separate property owned by the husband at the time of the marriage, during the period of marriage he is entitled to what would represent a fair return on that investment, and anything in excess of that fair return should be regarded as community property.

There are two rules here to deal with: the one that I just mentioned, the second one, and the first one which was advocated by Dixie Gilmore, and the other being advocated by Don Gilmore.

It is claimed by the petitioner here—it will be claimed, and he will try to prove so—that substantially all of the legal expenses that he incurred—.

THE COMMISSIONER: Yes, you say "80%".

MR. FREED: (Continuing)—in the defense—yes, we say 80%, but at least 90, and in fact I think if it were done all over again, after a study was made, it would probably be more than 80—but we expect to or we will [fol. 10] try to prove that substantially all of the legal expenses that were incurred by Mr. Gilmore were incurred to defend and protect his businesses, his investments, in those three corporations. If Dixie Gilmore, through her efforts, acquired a substantial or even a minor interest in those three corporations as her own, the General Motors Corporation with whom these three dealerships had agreements would be in a position to terminate the franchises or selling agreements on three months' notice.

We will offer evidence to that effect, and that there would be probable cause—we will try to show—for such termination, and that most likely would have resulted if

she had acquired through her efforts any of the stock in those three corporations.

We will also attempt to show here that that was almost the only consideration in the case as far as Mr. Gilmore was concerned. He had no real objections to a divorce. He thought there should be a divorce. There was no concern about alimony at all. He fully expected the Court to award alimony, which, by the way, the Court did, but finally discovered afterwards that the Court was in error and had to withdraw that award. That was a strange circumstance at the end of the trial of the case.

There was some joint tenancy property. There were two homes, one in which they lived in Belvedere, and another in which they had previously lived in Fairfax. Those two pieces of real property were vested in joint [fol. 11] tenancy in Don Gilmore and Dixie Gilmore as joint tenants. From our standpoint, and there at that time Mr. Gilmore recognized that she owned a half interest in those properties, so that was of no great concern to him either.

The Court will recognize that there is another petitioner here, Sue Gilmore. The final decree of divorce was entered on October 25, 1955, and shortly thereafter—I believe it was November 1st of that year—Don Gilmore married Sue Gilmore.

I forgot to mention, although it should appear somewhere, I think—

THE COMMISSIONER: I think it shows in your claim for refund, the last one.

MR. FREED: Yes. It happened, and I will mention that too, that the trial court, to everyone's surprise on Mr. Gilmore's side, awarded him the divorce. Under our procedure in California, upon awarding a divorce, the trial court enters an interlocutory decree.

THE COMMISSIONER: Yes, they have to wait a year before a final decree is effective?

MR. FREED: Yes. Dixie Gilmore did not accept that interlocutory decree; she took an appeal. An appeal was taken to the intermediate Appellate Court in California, the District Court of Appeal.

The District Court of Appeal reversed the trial court, and then, being dissatisfied with that, Don Gilmore peti-

tioned the Supreme Court, the highest Appellate Court, [fol. 12] for a hearing, and the hearing was granted.

The Supreme Court vacated the decision of the District Court of Appeal and affirmed the trial court. The result was that the trial court was finally affirmed, and on October 25, 1955, a final decree was entered.

The decision and opinion of the Supreme Court appears at volume 45, California Reports 2nd Series, page 142.

THE COMMISSIONER: Is that in the West system, also?

MR. FREED: That would be in the Pacific system.

THE COMMISSIONER: Do you have the Pacific citation convenient?

MR. FREED: Yes, we have it. It is 287 Pacific 2nd 769.

* * * *

[fols. 13-14] * * * *

[fol. 15] THE COMMISSIONER: All right. Whom will you have first, Mr. Freed?

MR. FREED: We have a witness who is due here at a quarter after ten.

MICHAEL L. HAUN, a witness produced on behalf of the plaintiffs, having first been duly sworn by said Commissioner, was examined, and in answer to interrogatories testified as follows:

THE COMMISSIONER: Will you give us your name for the record, Mr. Haun.

THE WITNESS: Michael L. Haun.

THE COMMISSIONER: Where do you reside, sir?

THE WITNESS: 1635 Gough Street, San Francisco, California.

THE COMMISSIONER: Mr. Freed, you may examine the witness.

## DIRECT EXAMINATION

MR. FREED: Q. Mr. Haun, you are an attorney licensed to practice in all the courts of the State of California and have been for a number of years, have you not?

A. I have, since October the 15th, 1929.

Q. Mr. Gilmore has been a client of yours, has he, for many years—Don Gilmore?

A. Yes.

Q. You were also the attorney for the three automobile dealerships in which he was interested?

[fol. 16] A. That's correct.

Q. In 1952 were you engaged by Don Gilmore to represent him in a divorce action filed by Dixie Gilmore, his wife at that time?

A. I was.

Q. What did you proceed to do generally when you were engaged as counsel in that case?

A. Well, as I recall it, at the time he was served with a copy of the complaint and summons he was also served with an order to show cause and a notice of taking his deposition. I contacted opposing counsel, requested time, which was granted, and we discussed the matter from time to time.

Do you wish me to continue?

Q. Did you make a court appearance at that time?

A. Not until the suit was filed in April, the first part of April, 1952. I don't recall when the first court appearance was, but I believe the matters were continued until possibly June or somewhere around in there, on an order to show cause. That was the first court appearance for temporary support.

Q. Was Dixie Gilmore awarded some temporary alimony pending the action?

A. She was.

Q. Was that by a court order?

A. That was.

Q. I have here the Clerk's Transcript on Appeal. You have seen it, counsel?

[fol. 17] MR. PESTER: I have.

MR. FREED: Q. I will refer you to the Cerk's Minutes dated June 6, 1952, in which it appears that the Court ordered Don Gilmore to pay Dixie Gilmore $1,250 per month, pendente lite, and $1,500 counsel fees on account.

That was counsel fees for her counsel, was it not?

A. Yes, and that is the order and the hearing I just referred to.

Q. At that time you were associated with Walter F. Freitas, were you?

A. Correct.

Q. Walter Freitas was engaged by Mr. Gilmore to become associated with you?

A. I am sorry, I didn't hear the first part of your question.

Q. Walter Freitas is an attorney at law who was brought into the case—I will withdraw that and reframe the whole question. It has become messed up.

Walter Freitas is an attorney at law whose office is in San Rafael, Marin County?

A. Yes.

Q. Your office is in San Francisco, is it not?

A. That is correct.

Q. I have overlooked to mention in my opening statement that the action brought by Dixie Gilmore was in the Superior Court in Marin County, the county seat of that county being San Rafael?

[fol. 18] A. That is correct.

Q. Mr. Freitas has offices in San Rafael?

A. In San Rafael, and I understand his practice is almost exclusively in that county.

Q. He became associated with you, and he was engaged by Mr. Gilmore? That is how that came about; isn't that right?

A. That is correct.

Q. You and Mr. Freitas joined together in the filing of an Answer to the Complaint of Dixie Gilmore, and that was filed on June 16, 1952. That is correct, is it not?

A. I believe so; if the record so states.

Q. Prior to the time that you and Mr. Freitas prepared and filed an Answer to the Complaint—and I wish to add thereto that there is a Cross-complaint as part of that Answer that you and Mr. Freitas prepared and filed on behalf of Mr. Gilmore?

A. Yes.

Q. In which Mr. Gilmore charges Dixie Gilmore with extreme cruelty and asks for divorce?

A. Correct.

Q. Coming back again to the question I had in mind, prior to the time that the Answer and Cross-complaint

were filed, did you individually or jointly with Mr. Freitas carry on any negotiations for the settlement of this case with the attorneys for Dixie Gilmore?

A. We did.

[fol. 19] Q. Prior to that time had there been any attempts made at reconciliation of the parties?

A. Oh, I would say slight attempts, up to about May the 15th of 1952, at which time Mr. Gilmore left the premises.

A. The home where they had been residing.

Q. Do you remember what those attempts were? Did you participate in them, for example?

A. I participated in those talks with Mr. Charles A. Christin, alone. That was before Mr. Freitas came into the case.

Q. Christin was one of the attorneys for Dixie?

A. One of the attorneys for Mrs. Gilmore. He was the original attorney for Mrs. Gilmore. He filed the suit.

Within a very short time, or at least before the hearing of June the 6th, it was definitely determined that there was no possibility of a reconciliation.

Q. It was determined then, was it, that the marriage was finished?

A. No question of that.

• • • •

[fol. 20] Q. Let me put it to you this way, so we can be as objective about this as possible, if I may:

Were there any conversations between you and Mr. Gilmore after that date directed toward saving the marriage?

A. None after May the 15th, 1952.

Q. Did you receive any instructions whatsoever from Mr. Gilmore after that date to render any services towards saving the marriage?

A. No.

Q. What about Mr. Freitas? Were you ever present at any time when that matter was discussed, whether or not you or Mr. Freitas or both should render any services after that time that you just mentioned to save the marriage?

A. Not that I recall. I have a definite impression that after May the 15th, 1952, at the time he left the home, there was no possibility of saving this marriage.

[fol. 21] Q. Turning to the question of negotiations, did you individually or with Mr. Freitas carry on any negotiations with any of the attorneys for Dixie Gilmore toward the settlement of this controversy between Mr. and Mrs. Gilmore? That is, prior and up to the time that you filed an Answer and Cross-complaint which was in the middle of June, 1952.

A. I don't believe there were any negotiations prior to the filing of the Answer and Cross-complaint.

Q. Do you remember any negotiations after the filing of the Answer and Cross-complaint?

A. I do.

Q. Do you remember what they were, and, if so, would you relate them.

A. Well, my best recollection is that in the fall of 1952—I can't say the exact date, but there was a conference with a Mr. Gillen, who was then associated in the case, and at that conference, on behalf of Mrs. Gilmore, Mr. Gillen made a definite demand of one half of what he considered to be the community property of the parties, and arriving at that figure, as I recall, and I refreshed my memory by looking through my old files, roughly, he allowed Mr. Gilmore—well, I believe it was $240,000 as separate property before the marriage, and that that had increased to $800,000. Subtracting those two figures, he arrived at $540,000, of which he demanded one half, contending it was community property. In other words, demanding $270,000 by way of settlement, plus [fol. 22] attorney fees and court costs, and no alimony.

Q. Was the basis for that settlement advanced to you at that time by Mr. Gillen?

A. Well—

Q. I mean; specifically.

A. As I stated—

Q. What property was he referring to?

A. Well, he, I think, referred particularly to the San Francisco property, the increase in the value of the corporation.

Q. Which corporation?

A. Don Gilmore San Francisco.

THE COMMISSIONER: That was a Chevrolet dealership, was it, Mr. Haun?

THE WITNESS: That's correct.

MR. FREED: Q. You said "particularly." Was any reference made by him to the other dealerships, Hayward and Riverside?

A. That I can't recall, I am sorry. I can't answer that. I would only be assuming. There is a possibility they must have included the other two corporations.

Q. Do you remember what the legal basis was for his claim, Mr. Gillen's demand, of $270,000 as a settlement?

A. Well, as I previously testified, it was his contention that that was community property.

Q. What was community property?

A. There was a total community property of $640,000 [fol. 23] pardon me, 540,000. He was demanding one half of it.

• • • •

MR. FREED: Q. What was your response to that demand, Mr. Haun?

A. We thought it was entirely out of order.

Q. Did you make any offers at that time?

A. I don't recall that we did. We might have made some offer to pay her a reasonable amount for—oh, for a number of years, until such time as she could rehabilitate herself. So far as conveying any interest in any of the corporations, we did not consider that. We thought that the demand was entirely out of order.

Q. Did you have any discussions at that time about alimony?

A. I can't recall that too well. We might have countered with an offer of substantial, as I said, alimony payments for a period of time.

Q. That is what you were referring to?

A. Until such time as she would rehabilitate herself. As far as seriously considering the offer of $270,000, I personally thought that was entirely out of order.

Q. Did you report to Mr. Gilmore the negotiations that you had?

[fol. 24] A. I believe we did.

Q. Did Mr. Gilmore give you any instructions in regard to further negotiations?

A. No. I think he said something to the effect that "If that's their line of thinking, why, there isn't any chance about it. I haven't this kind of money. I couldn't raise it."

His connection with the Chevrolet people, he couldn't possibly have raised that kind of money had he so desired, even if he desired to settle it for that figure.

Q. Were there any negotiations after that with the attorneys for Mrs. Gilmore?

A. You mean for settlement?

Q. Yes.

A. Not that I recall, until after the case had been tried.

Q. The case went to trial, I think, March 13th, 1953—March 16, 1953?

A. You might have to lead me on those dates a little bit.

MR. FREED: We have a stipulation that we propose to offer in due course that contains those dates, so I will make reference to the stipulation from time to time.

Q. At the time you went to trial, you were associated with another attorney, Wallace S. Myers; is that correct?

A. That's correct.

Q. He was substituted, was he not, for Mr. Freitas?

A. Yes.

[fol. 25] Q. Mr. Freitas' active participation in the case with you ended about when? Do you remember?

A. In early January of '53.

Q. Did Mr. Myers come into it shortly after that time?

A. I would say within a week or so.

Q. Mr. Myers has his office in Marin County too, has he not?

A. That is correct.

Q. He is reputed to be a trial attorney, is he, in Marin County?

A. His reputation is very good as a trial attorney. I personally consider him the best trial attorney in Marin County, if I may say so.

Q. That is quite a compliment. The trial continued for a number of days, about 23 days or so, did it not?

A. Yes.

Q. During the course of that trial, what was your chief objective that you and Mr. Myers had?

A. Well, it was to naturally conserve the three corporations and to keep them whole, it being our contention that they were his separate property and that it was our job, we felt, to prove that to the Court if we could.

Q. You participated each and every day, did you not, with Mr. Myers in the trial of that case?

A. I did.

Q. Prior to the trial of that case, you and Mr. Myers made a certain amount of preparation for the trial?

[fol. 26] A. Yes, we did.

Q. Did you and Mr. Myers prepare it together?

A. Yes, we did.

Q. Did you know a Mr. Schwerin, an accountant?

A. I do. There might have been certain conferences that Mr. Myers had with witnesses separately, and which I might have had, but we were in contact with each other all the time, kept each other informed. Most of the conferences were together.

Q. What part did Mr. Schwerin play in the preparation for the trial of that case?

A. Well, he was called into the case to examine the books, the corporate books and the private accounts of Mr. Gilmore, primarily to determine what had happened to the earnings of the corporation, the payments that had been made to Mr. Gilmore, and primarily to determine whether or not there was any community property.

Q. Did you have any meetings with Mr. Schwerin?

A. We did, many meetings.

Q. Before the trial of the case commenced; is that correct?

A. Yes.

Q. What was the work that was done? How would you characterize the work that you did with Mr. Schwerin at those meetings?

A. Well, he would explain to us from time to time where money had gone, been paid to Mr. Gilmore, Mr.

Gilmore receiving a certain salary, and he would follow down what happened to that salary.

[fol. 27] There were times that Mr. Gilmore would borrow from the corporation and pay back. It was a rather complicated thing in an accounting proposition. It was something new to me, and it was to get some light on that particular phase of the case that we had these conferences.

Q. What were you trying to prove through Mr. Schwerin?

A. Well, as I said before, that the property, the corporation itself, including the increases, was the separate property of Mr. Gilmore; that any community property, being such property as had been acquired through his personal efforts, had been expended in support of the community, paying community debts, the traveling, what was used for traveling, their living expenses and so forth.

Q. In the defense of the case in behalf of Mr. Gilmore, and the prosecution of the Cross-complaint of Mr. Gilmore against Mrs. Gilmore, was there any concern on the part of you and Mr. Myers in respect to alimony?

A. Not particularly. Not so far as I was concerned. As I previously stated, we made an offer to pay her something for a period of time, and I felt sure that the Court would award her something along that line, temporarily. Mr. Gilmore was willing to do that. There was no question about that.

Q. Quite a bit of time was devoted in the trial of the case to the conduct of the parties, was it not, Mr. Haun?

A. Yes, I believe so. I believe the Transcript will [fol. 28] show that.

Q. So far as you were concerned, and so far as you know, having been associated with Mr. Myers—although we will call him as a witness to speak for himself—was there any relationship between your efforts and the trial of those matters which related to the conduct of the parties and the community property issues?

A. Do you mean as to the outcome? I don't quite understand.

Q. Yes, the outcome as far as your objectives were concerned.

A. Yes, I think we both felt that every bit of evidence that—

MR. PESTER: I am going to object to that, as to what they both felt. He may say what he felt.

THE COMMISSIONER: State what your feeling and effort was, Mr. Haun.

THE WITNESS: My effort was along that line. Since we had the testimony, I felt that it should be offered, everything should be brought before the Court. The Court possibly would find that she was the cause of this marriage failure, and that in the ultimate end, if it should find that this was community property, under the laws of California if it granted a divorce to Mr. Gilmore, it could still give him the community property. In other words, if he found that there was a certain interest in these three corporations.

MR. FREED: Q. Do you have anything to say with [fol. 29] reference to the power of the Court? Did you have that in mind in regard to the allocation of the community in the event one or the other received the divorce?

A. Well, yes. My understanding was and is that the prevailing party in a divorce action, in so far as community property is concerned, the Court must grant to the innocent party more than 50% of the community property, whether it is 51%, but it must be more, as I understand California law.

Q. Were you aware during your representation of Mr. Gilmore of the effect on the General Motors Corporation, both the Chevrolet Division and the Pontiac Division, of the acquisition by Dixie Gilmore of any interest in the stock of those corporations, and what effect it might have on the contractual relationship of General Motors Corporation and the three dealerships?

MR. PESTER: I am going to object to that on the ground that any effect that it might have on a contractual relationship with Mr. Gilmore and the corporation would be best evidenced by the agreement that they had between them.

THE COMMISSIONER: I think you have some direct evidence on this point anyway, don't you, Mr. Freed? Don't you have a witness that has some direct—

MR. FREED: Yes, and I want to establish for the record that Mr. Haun, having been the attorney for the three corporations as well as Mr. Gilmore, for a number of years, whether or not he was aware of the fact that [fol. 30] these three dealerships operated under a franchise of the General Motors Corporation, and what the effect might be under those franchises on the dealerships.

THE COMMISSIONER: I will sustain the objection as to what the effect might be, unless you show he has personal knowledge of it. I will permit you to prove by him that he knew of this franchise.

MR. FREED: I am trying to get about it, in a roundabout way, I suppose.

Q. Mr. Haun, did you have any knowledge of what the effect might be?

A. Yes, generally I did. At that time, particularly General Motors Corporation was very strict—

MR. PESTER: I am going to object for the same reason I gave before, and for the further reason that the question which was asked has been answered. This last statement that he is undertaking to make is a voluntary statement.

THE COMMISSIONER: Yes. He had personal knowledge. Now, let's take it from there. Go ahead, Mr. Freed.

MR. FREED: Q. What was your knowledge?

A. Well, generally I knew the contents of the franchise contracts. Not in particular, naturally. I can't say what would have happened, but I do know this: Generally, if Mr. Gilmore did not have complete control of those corporations, the chances were nine out of ten that he would lose the franchise very shortly, within a year at the most.

[fol. 31] Q. In respect to the conflicting claims of Mr. and Mrs. Gilmore in the community, what legal theory was advanced by Dixie Gilmore's counsel that there was in this case a substantial appreciation in the community; first that there was a substantial appreciation in value in the stock interests of Don Gilmore in the three automobile dealerships, and secondly that that appreciation consisted primarily of community property? Do you remember the theory that they advanced?

A. Yes.

Q. That they argued?

A. Yes. There was one line of cases in California that held that in such case one half of the appreciation would be community property, less a reasonable return for the investment. I think the rule is established, in certain cases, seven or eight percent that he would be entitled to as his original investment, plus a seven or eight percent of the increase, and the rest is held to be community property.

Q. What was the theory that you and Mr. Myers advanced and argued to the Court?

A. Our theory was that since it was his separate property originally, it continued to remain his separate property. If we could establish the fact that he had been amply paid for his services rendered to the corporation, such as his salaries from the various corporations, those salaries being community property. In other words, if the community had been amply paid for the services that had been rendered by him, we felt that [fol. 32] under another line of cases the Court would hold that the appreciation would also be separate property.

Q. What were you able to establish with respect to those salaries? Did you establish whether or not they were ample?

A. I believe we did. The Court so held, particularly in the findings of the lower Court, and ultimately in the holding of the Supreme Court of the State of California.

Q. Did you also establish whether or not any of those salaries went back into the investment, or whether they were fully spent?

A. We established that they were fully spent. As a matter of fact, as I recall it now, the community even owed his separate estate monies they had overspent.

MR. PESTER: If the Court please, I am going to object to this on the ground that it is not the best evidence.

THE COMMISSIONER: Doesn't all this show, Mr. Freed, in the findings made by both the trial court—

MR. PESTER: Yes, they would.

THE COMMISSIONER: (Continuing)—and on appeal?

MR. FREED: No, I don't believe it was shown that more money was spent in the marriage than the amount of his salaries. I believe the findings showed there was no community property. That is definite, and in the opinion of the Supreme Court that is affirmed.

MR. PESTER: I think whatever findings were established and found by the Court, the findings and the decree [fol. 33] are the best evidence, and this witness should not be permitted to testify.

THE COMMISSIONER: Yes, I will sustain the objection. However, he may show what efforts he rendered as an attorney on these various matters, what work he performed, what services he rendered.

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[fol. 34] MR. FREED: The Minutes of the Clerk of the Superior Court show that on April 24, 1953, the Court ordered $750 per month alimony for five years for Dixie Gilmore, to be terminated on death or remarriage, and the alimony to be reconsidered at the end of five years.

Do you remember that?

A. That is correct.

Q. Eventually, what happened to that award of ali-[fol. 35] mony to Dixie Gilmore? Do you remember?

A. Well, that was omitted from the findings, the ultimate findings and the ultimate judgment of the trial court.

Q. If there is no objection, would you explain—if your services were in relation to it—what happened that resulted in the final omission from the decree of any award of alimony to Dixie Gilmore.

A. Because under the California law at that time the trial court was powerless to award alimony to a guilty wife.

THE COMMISSIONER: Is that what you urged, Mr. Haun, before the trial court? Did you take that position as an attorney?

A. That position arose after the completion of the trial, yes, and on the preparation of the findings and the motions for new trial and so forth.

MR. FREED: Q. Who called that to the attention of the trial court? Was it you, or Mr. Myers, or someone else?

A. I am sorry. I believe we did, one or the other. Mr. Myers actually is the one that addressed the Court practically throughout the entire matter. Now, I might have made the legal research on it, or he might have.

Q. Was there any dispute over that rule that the spouse against whom the divorce is awarded under California law has no right to alimony?

A. I don't think so.

Q. In other words, there was no opposition to it; is [fol. 36] that what you are saying?

A. You mean by the attorney for—

Q. Yes, did they oppose the point or not?

A. Well, I believe they conceded it after reading the cases. It is settled law on the matter.

Q. Were the theories advanced by Dixie Gilmore's counsel and the efforts they made to establish that there were substantial community property interests in the stock of those three corporations regarded seriously by you?

A. I am sorry, Mr. Freed,—

THE COMMISSIONER: Will the Reporter read the question.

(Reporter read the last question)

A. Yes, they were.

MR. FREED: Q. Was there anything else in the case at all as serious as that?

A. My ears are getting bad.

Q. Was there anything else in the case as serious as that?

A. No.

Q. Aside from that, was there anything else in the case that was serious?

A. Well, in relation to what?

Q. The community interest, the assertion by Dixie Gilmore of substantial community interests in the stock of those three corporations, those three dealerships?

A. No. That, to me, was the entire case. As I meant to say, I lived with this thing for about three years, and [fol. 37] that was my sole hope and effort, everything extended towards that particular point.

Q. You rendered services on the appeal that was taken by Dixie Gilmore from the interlocutory decree of divorce, did you not?

A. Yes.

Q. There was a Brief that was filed on behalf of Dixie Gilmore, who was the appellant. That Brief is entitled "Appellant's Opening Brief in the District Court of Appeal." Do you remember such a Brief?

A. Yes.

Q. You and Mr. Myers joined together in filing a Respondent's Brief, did you not?

A. We did.

Q. You and Mrs. Myers jointly continued to render services throughout the Appellate stages of this proceeding?

A. We did.

Q. All the way through the Supreme Court?

A. Yes.

• • • • •

[fol. 38] MR. FREED: Q. What was your objective in respect to the services you rendered on appeal?

A. The same as they had been throughout the investigation and trial in the lower Court.

Q. Namely, what?

A. To establish the fact that there was no community property.

Q. In respect to this particular property?

A. Particularly the corporations. I think we conceded that the two homes were joint tenancy property.

Q. Mr. Haun, in the Briefs that were filed by both parties on appeal, and Petitions as well on appeal, there was considerable discussion regarding the conduct of the parties. Was your concern in respect to the conduct of the parties, as treated on appeal, any different from that concern which you had during the trial of the case?

A. I believe not.

Q. What was your concern?

A. The concern, as I previously stated, was that by bringing out those facts in the Briefs, it was our hope to establish and to have the Appellate Court affirm the

[fol. 39] lower Court, wherein it granted the divorce to Mr. Gilmore, which, naturally, as I previously stated, would preclude giving any of the community property to Mrs. Gilmore.

Q. I am not sure that it is clear in the record, Mr. Haun. What was the purpose for associating both Mr. Freitas and after that, Mr. Myers in the representation of Mr. Gilmore?

A. Well, in the first place, I felt that the case involved so many issues that it was what I considered more than a one man case. I felt that there should be at least two attorneys in this case. I didn't think that one man—I don't care how good he is—could handle this type of case as it should be. No. 2, I felt that Marin County counsel should be associated, because at that time I was not too well acquainted with the various workings of that particular county, the rules of the Superior Court and so forth.

Q. Mr. Haun, you received certain compensation, did you not, from Mr. Gilmore for your services?

A. I did.

• • • •

[fol. 40] Q. Were the amounts which you received from Mr. Gilmore for your services reasonable compensation for your services?

A. Yes, I would say very reasonable.

• • • •

[fol. 41] MR. FREED: Q. Are you able to say approximately what portion of your total services for which you received the fees in '53 and '54 were rendered for the defense and protection and preservation of Mr. Gilmore's interests in those three businesses?

A. I would say that a hundred percent of my services were rendered for that purpose, because after May the 15th there was no effort to save the marriage, and all I was concerned with was conserving these three corporations. That is to say, to prove, if possible, that they [fol. 42] continued to remain separate property, free and clear of any lien of Mrs. Gilmore under the community property laws of this State or otherwise.

MR. FREED: That will be all at this time.

THE COMMISSIONER: We will take a short recess, counsel, for about five minutes.

(Short recess)

THE COMMISSIONER: You may cross-examine, Mr. Pester.

CROSS EXAMINATION

MR. PESTER: Q. Mr. Haun, did you testify that you were interested here merely in conserving Mr. Gilmore's property?

A. Primarily, yes.

Q. Could you do that without trying the divorce action?

A. No, I don't see how you could.

Q. Then, some time as a part of the time that you spent in this matter was devoted to the divorce proceeding other than the property issue?

A. Well, I think they are intermingled. I don't think you can help that. I don't think you can divide them.

My ultimate purpose was to save this property, as I said, but in order to do so, naturally there was some evidence which was offered upon which the Court could grant the divorce to Mr. Gilmore.

Q. Yes, and you couldn't draw a straight line between one or the other, or between the two of them?

A. I don't think so. It would be rather difficult, although I think percentage-wise you could possibly make an estimate.

[fol. 43] Q. In the case on appeal, practically no discussion was had with reference to the property issue, was there?

A. I don't recall the Briefs on that. I think there was some considerable part of it, but there again the point comes out—I don't know just how to express it—but if we could make out Mrs. Gilmore as being the real cause of the failure of this proposition, this marriage rather, I felt that that would go a long way in upholding the opinion or the decision of the lower Court.

Q. If Mrs. Gilmore were the guilty party, then the Court could not award her alimony; isn't that correct?

A. That is correct.

Q. But so far as community property was concerned, that would still have to be divided, if there were any; isn't that correct?

A. It would not have to be, no.

Q. In other words, if two parties, husband and wife, have divorce litigation and community property is involved, the guilty party is deprived of the community property?

A. Could be. There are many California cases on that.

Q. You stated that you had no concern so far as the awarding of alimony was concerned in this proceeding?

A. I don't think I said "no concern." I wasn't particularly interested in that phase of it.

Q. You have been attorney for Mr. Gilmore over a long period of years?

[fol. 44] A. I have, ever since 1932.

Q. Do you know whether or not in 1952 Mr. Gilmore was paying alimony to a former wife of his?

A. I think he was.

Q. Was any mention made between you and Mr. Gilmore respecting the payment of alimony to another person?

MR. FREED: Just a moment. I object to that question. That seems to be irrelevant.

THE COMMISSIONER: What is the relevancy of this other matter which is not involved in this particular divorce action?

MR. PESTER: There is a question whether or not the time was spent on the property issue other than alimony, just community property, or whether alimony was also an issue in this case. I think it was also an issue.

THE COMMISSIONER: But not for another wife, Mr. Pester. You are asking now about a preceding marriage. I will sustain as to that, unless you can show me the relevancy of it.

MR. PESTER: I am just—

THE COMMISSIONER: Using that for illustration?

MR. PESTER: No, as a foundation as to whether or not this matter was discussed, and if it was, that Gilmore was interested in making sure that this wife didn't get alimony.

THE COMMISSIONER: You may ask him as to that. That would be pertinent.

MR. PESTER: Q. Now, Mr. Haun—

A. No.

[fol. 45] MR. FREED: What is the question?

MR. PESTER: I am going to ask it right now.

Q. Did Mr. Gilmore make any statement to you that he didn't want to be paying alimony to Dixie at the end of this proceeding?

A. I can't recall it at the present time.

Q. The only thing you recall is the community property issue?

A. Oh, I don't believe I testified that that was the only issue in the matter. I say that I wasn't particularly concerned with the alimony end of it. In fact, I felt that he probably would have to pay for two or three years, or maybe longer.

Q. The contentions of the parties will be shown from the Briefs that were prepared and filed in connection with the Appeals.

A. I don't quite get the purpose of your question.

Q. You said something about the contention of the parties in connection with this litigation. I am asking you now whether those contentions will be reflected in the Briefs that were filed in that divorce litigation.

• • • • •

[fol. 46] THE WITNESS: I think they do. At least, most of them do. There might have been additional contentions, but primarily I think they contain the issues.

MR. PESTER: Q. Didn't you testify on direct examination that primarily the issues on appeal were the same; that is, your efforts were the same as in the trial of the case?

A. That's correct.

Q. The Court awarded attorney fees to Dixie's attorneys. Do you recall that?

A. That is correct.

Q. Would you say that the amounts which the Court awarded to her attorneys were reasonable?

• • • • •

[fol. 47] THE WITNESS: Are you referring to all of the money that they received? That is, on the Order to Show Cause and clear on through the trial and appeal and so forth?

MR. PESTER: Q. I am referring to the original Order wherein the Court awarded the divorce decree and set the fee at $10,000.

A. Well, prior to that there was an Order for $1,500.

Q. And this $10,000 was in addition to the $1,500?

A. Correct.

Q. Would you say that that was a reasonable fee for the services rendered?

A. Taking into consideration the services rendered, the results obtained by Mrs. Gilmore's attorneys, I would say yes.

Q. Are you distinguishing the results obtained as one of the factors in the amount to determine the reasonableness?

A. I think that is one of the elements; the amount of money involved, the results obtained. I think such things are to be taken into consideration in fixing a fee.

Q. You testified with reference to Mr. Schwerin. Was he an accountant?

A. Yes, Certified Public Accountant.

Q. Did he furnish you and Mr. Myers with the documents and exhibits which were offered in connection with the community property?

A. You mean the sheets that he made up eventually?

[fol. 48] Q. Yes.

A. Yes.

Q. Did anyone else, in addition to Mr. Schwerin, furnish you some documents or information that you put into evidence?

A. That I can't recall. It's possible that someone from the Gilmore Corporations might have furnished accounts. I can't answer that.

Q. You didn't prepare any sheets or exhibits for the trial of the case, did you?

A. I did not.

Q. Primarily it was the functions of the trial attorneys to put into evidence the sheets prepared by Mr. Schwerin?

A. Yes, I believe so.

THE COMMISSIONER: Just a minute. Would you please read the last question and answer.

(Record read)

MR. PESTER: I believe that is all, Your Honor.

THE COMMISSIONER: Any redirect, Mr. Freed?

MR. FREED: Yes, with respect to the last question and answer. Would you read that question and the one before it.

(Record read as requested)

## REDIRECT EXAMINATION

MR. FREED: Q. Did you review the sheets that were prepared, work sheets prepared by Mr. Schwerin?

A. Oh, yes, we did. I did, and Mr. Myer did.

Q. You reviewed them with Mr. Schwerin, did you? [fol. 49] A. Yes.

Q. Was that the subject of conferences between you and Mr. Myers and Mr. Schwerin?

A. Many conferences.

Q. I think you were asked something like this: Whether it was the primary function of the trial attorneys to offer or to introduce these sheets into evidence. Who actually offered those sheets into evidence at the trial of the case? Do you remember?

A. You mean as between the attorneys?

Q. As exhibits, yes, if that is what the question was directed to. I am not sure.

A. I think Mr. Myers and myself. I am not too sure on that; but it could be that those are offered in evidence at the very beginning of the trial as a stipulation to the correctness, because opposing counsel had engaged other accounts to go over the books prior to this at Mr. Gil-

more's expense, and they had checked. Now, that is my best recollection, that those records were offered at the beginning of the trial.

However, I think the Transcript had better speak for itself on that. If not, then it was offered by us.

Q. Were the Transcripts prepared by Mr. Schwerin alone, or were they prepared through conferences with you and Mr. Myers?

A. Well, there were many conferences. Mr. Schwerin and his son—there was a vast bulk of documents that they had to sort out, and I don't recall particularly, but [fol. 50] I think we had many conferences as to what those documents contained, particularly, which of them, for example, were community property obligations, and which might have been separate obligations of the corporation or of Mr. Gilmore. We discussed such things as that many times, so that when finally the thing was funneled down into a definite determination as to which were community obligations and which were separate.

• • • •

THE COMMISSIONER: The record may indicate that the accountant, Mr. Schwerin, who has been referred to here by Mr. Haun in his testimony, has died prior to the trial of this case.

• • • •

MR. FREED: Q. Mr. Haun, are you able to state what elements you took into account in determining the fees that you charged Mr. Gilmore for the years 1953, '54 and '55, too, for that matter?

A. I think it was the time, the difficulty of the issues. I recall there was a District Court of Appeal case that [fol. 51] had been decided upon, which the theory was advanced, which was the same as our theory of this community property—separate property element. That was a petition in the Supreme Court at the commencement of this trial, as I recall, and I wrote the attorneys who represented the defendant in that matter, and asked them to advise me immediately whether or not a rehearing or, rather, a hearing would be granted by the Supreme Court. During the course of this trial, even, I received a tele-

gram from them wherein they stated that the petition in the Supreme Court had been denied, therefore affirming the holding of the theory that I have tried to explain here this morning.

Q. Are you through testifying as to what the elements were? You said time, and what else was it?

A. Well, the time—

Q. The difficulties?

A. (Continuing) — and the difficulty that we had. Oh, there was a lot of leg-work. The Transcript would show all of the evidence that we acquired, going into all the little details, particularly in showing certain testimony of Dixie to be untrue. One, for example, would be—

MR. PESTER: I am going to object to that as immaterial. I don't think that is material to this case, as to what evidence in that divorce action was true or untrue.

THE COMMISSIONER: But he can state the work he did. What other elements did you take into account, Mr. Haun?

[fol. 52] THE WITNESS: Well, the time, the seriousness of the question. It hadn't been definitely decided in California. This theory, as I stated before, there was a possibility of it being held community, and Mr. Gilmore being allowed a certain percentage of that increase. That was a serious question, and the various elements of it. Then, there were the 21-23 or whatever days of trial, and in Marin County you don't start at 10:00 o'clock, you start at 9:30, and you stay there probably till 5:00, with about 45 minutes for lunch. The time there, going across the Bay every day, and I think that is about all I can say on that.

To me, having been associated with Mr. Gilmore for 32 years—rather, since 1932—I practically lived this case for about three years there.

MR. FREED: No further questions.

## RECROSS EXAMINATION

MR. PESTER: Q. You were doing other work for Mr. Gilmore and the corporations during this same period of time, were you not?

A. Correct.

Q. Do you recall whether or not the checks that you received would indicate what work it was for?

A. Oh, yes.

Q. The checks indicate—

A. They were all separate. I was on a retainer with the corporation, otherwise, and those checks, by their [fol. 53] very amounts, I can identify them.

Q. They didn't specify on the check work for which the check was being submitted?

A. You mean the check for this divorce case?

Q. Any check that you got from Mr. Gilmore or the corporation.

A. Probably not in so many words, but his checks to me for services in this were drawn on his personal account, practically all of them. There might have been one or two, but I believe all of them, practically all of them, were drawn on his personal account.

Q. Did you keep a time record in your office as to the work you did?

A. I did not.

Q. You and Mr. Myers didn't sit down with Mr. Schwerin and go over the books of the corporation with him, did you?

A. I don't recall going over the books of the corporation as such, no.

Q. In other words, when Mr. Schwerin would bring in a document or documents, you would go over those documents with him in your office or Mr. Myers' office?

A. That is true. He would apparently go over the books, and he would bring us in an entire list. Most of those conferences were held in the office of Mr. Gilmore.

MR. PESTER: I believe that is all, Your Honor.

[fol. 54] FURTHER REDIRECT EXAMINATION

• • • •

DON GILMORE, the plaintiff in this action, having first been duly sworn by said Commissioner, was examined, and in answer to interrogatories testified as follows:

THE COMMISSIONER: You are Mr. Don Gilmore, the plaintiff in this suit?

THE WITNESS: Yes, sir.

THE COMMISSIONER: Where do you live now, Mr. Gilmore?

THE WITNESS: I live at 12 Crest Road, Belvedere.

THE COMMISSIONER: All right, Mr. Freed.

DIRECT EXAMINATION

MR. FREED: Q. Mr. Gilmore, about how long were you in the automobile business at the time you married Dixie Gilmore? How long had it been?

A. Well, I was at that time 34 years a Chevrolet dealer.

Q. Had you been in any other kind of business during that period of time?

A. None.

Q. That was the only business that you had been in. [fol. 55] Did you know any other business other than that?

A. None whatever, except the automobile business.

Q. At the time that Dixie filed her divorce action against you, you were the president, were you, of the three corporations?

A. That's correct, I was president and treasurer.

Q. And treasurer? What was your position with respect to the management of those three businesses?

A. I was active manager.

Q. There were other managers under you; is that it?

A. That's right.

Q. You received substantial salaries—the amounts of the salaries will be in the stipulation—for your services from those three corporations?

A. I did.

Q. At the time the divorce action was filed, how old were you?

A. Well, I have to go back. It was in 1942, it was filed, wasn't it?

Q. '52.

A. Well, I'm 68 now, so that would make me 62.

Q. About 62, yes. In this divorce action that was filed, at the beginning were there any attempts at reconciliation?

A. Oh, yes. Prior to the divorce action, in '52, Dixie Gilmore went down south to Beverly Hills, and I tried very hard through long distance phoning and a few [fol. 56] mutual friends of ours in Los Angeles to effect a reconciliation. She flew back, and I really felt we might make a reconciliation, but then her attitude changed entirely and there was no chance.

Q. Through your attorneys, did attorneys Michael Haun and Walter Freitas make any attempts at reconciliation?

A. Only through Mr. Haun.

Q. About how long did that go on, your interest in reconciliation continue, commencing with the time the divorce action was filed? About how long after that was thought given to reconciliation—I mean, thought between you and your attorney?

A. Well, the attempt at reoconciliation was prior to the filing of the divorce action.

Q. In June of 1952 you filed an Answer and Cross-complaint in the Gilmore vs. Gilmore proceeding. At that time did you have any interest at all in preserving the marriage?

A. Not at that time, no.

Q. Or thereafter?

A. Not thereafter.

Q. With respect to a divorce, what was your intent so far as it was expressed to the attorneys? As far as your attorneys are concerned, what was your intent about getting a divorce, or, who was to get the divorce?

A. Well, divorce was not new to me, and I had always figured it was a woman's prerogative to get the divorce. That's about all I can say about it.

[fol. 57] Q. Were you familiar with the negotiations, if any, that your attorneys carried on in your behalf with the attorneys for Dixie Gilmore?

A. Of what nature?

Q. To settle the case.

A. I believe it's my recollection that they discussed with me the possibility or, rather, not the possibility but the subject of her demands as it affected community property.

Q. As far as you are concerned, what was the principal thing in that divorce case?

A. Well, it was maintaining and preserving my income-producing business.

Q. Did Dixie ever demand any part of that business directly, in her conversations with you?

A. Yes. She told me she was going to really take me down the line.

Q. Did you have any concern regarding the alimony that might result from the case?

A. No, I felt the Court would be fair and limit it to a certain length of time.

Q. You owned some other property, I believe, did you not, you and Dixie together? I mean, for example, the home. Did you own that together?

A. Yes, in joint tenancy, the two homes.

Q. Was that a subject of any concern to you in the divorce case?

[fol. 58] A. No.

* * * * *

MR. FREED: Q. There was an issue, was there not, Mr. Gilmore, at the time of the final decree whether during the period of the appeal any community property had accumulated? Was there, or was there not?

A. I don't recall.

Q. Mr. Gilmore, what was the demand, according to your knowledge, that Dixie was making with respect to the community property?

A. Well, my understanding was that she wanted half of the so-called increase in the assets of the corporation plus the Belvedere home.

Q. You were a General Motors dealer for many years, were you not?

A. Entirely General Motors.

Q. In your relations from time to time with General [fol. 59] Motors, your dealerships would enter into franchises or selling agreements, would they not?

A. Yes, at periodical times.

Q. Mr. Gilmore, you owned all the stock in the Don Gilmore San Francisco corporation, did you not?

A. That's correct.

Q. Do you know from your dealings with General Motors Corporation whether you could entrust that ownership with another stockholder as well as yourself? That is to say, someone else who owned part of the stock with you, with or without the consent of General Motors?

A. You could not do it without the consent of General Motors, and the new stockholder would have to be approved by the corporation.

Q. You mean approved by General Motors?

A. General Motors Corporation, Chevrolet Motors Division.

Q. And the same thing applies to Pontiac, as far as you know?

A. The same to all the General Motors Divisions.

Q. In other words, have you had experience on that subject?

A. I have had. I have attempted to sell part of my stock at one time to an employee of mine, and I had to have that approval before I could do it.

Q. Do you know whether they would have approved Dixie Gilmore as a co-owner of the stock?

MR. PESTER: I am going to object to that as calling for a conclusion.

[fol. 60] THE COMMISSIONER: That would be speculative, but he knows and he has testified that it couldn't be done without the consent of General Motors. I think that is the pertinent fact, Mr. Freed.

MR. FREED: Q. You communicated that to your attorneys?

A. In this divorce trial?

Q. Yes, in the divorce action.

A. Yes.

* * * *

MR. FREED: Q. In your agreements with the General Motors Corporation, there was certain capital structure, was there not, that was required?

A. There are very rigid capital requirements for a Chevrolet dealer.

Q. Before you can make any changes in the capital structure, downward, that is to say, below the minimum, would the consent of General Motors be required?

A. Well, it would be [illegible], because you don't go below their standards.

Q. In other words, if you went below the standards, [fol. 61] your contract would be subject to termination by General Motors?

A. That's correct.

Q. This selling agreement, direct dealer's selling agreement with Chevrolet Motor Division of General Motors Corporation provides—I will read it in this manner, if there is no objection—

MR. PESTER: Anything you want to read into the record as to what that provides is agreeable to me.

MR. FREED: I would like to read into the record from the direct dealers selling agreement between the Chevrolet Motor Division, General Motors Corporation, and Don Gilmore, San Francisco, paragraph 2B—B 2:

> "If Dealer does not develop the sale of Chevrolet motor vehicles and chassis to the satisfaction of Seller,"

Seller is the General Motors Company.

> "or does not conduct his business in accordance with any requirement set forth in Sections 11 and 12, Sections 14 to 19, inclusive, or Section 21 of this Agreement, to the satisfaction of Seller, Seller may terminate this Agreement by giving to Dealer written notice of termination to be effective three (3) months after receipt of such notice.

B. (3)

> Seller may terminate this Agreement immediately by delivering to Dealer or his representative written [fol. 62] notice of such termination in the event of the happening of any of the following:—"

I will refer to subsection C—

> "Any sale, transfer, relinquishment, voluntary or involuntary, by operation of law or otherwise, of any interest in the direct or indirect ownership or active management of dealership without the prior written approval of Seller."

Now, on form No. GSD-201-A, Chevrolet-54 of the Agreement, which is not bound, I would like to read Paragraph Third as follows:

> "This is a personal contract being entered into in reliance upon and in consideration of the personal qualifications of and representations with respect thereto of Don Gilmore, jointly, Dealer or partners in the dealership or representative of the Dealer who actively and substantially participates in the ownership and/or operation of the dealership, the individual or individuals designated shall be responsible for any act or omission of any dealers, agents or employees which may be contrary to the purposes and objectives of this agreement or the obligations of Dealer hereunder. Dealer shall not transfer or assign or attempt to transfer this Agreement or any right or obligation hereunder. Dealer shall not make nor [fol. 63] suffer to be made any change in the ownership, financial interests or active management of Dealer without the prior written approval of Seller."

Also, part of this Agreement numbered page 2, but it is loose and not bound, is the Dealer's Statement of Ownership, Financial Interest and Active Management. This sets forth the names of the officers and also the capital of the corporation. Under paragraph 3, entitled "DEALER'S WARRANTY AS TO PRESENT STATUS" there is the following:

> "The undersigned dealer, in consideration of the offer to him of the Chevrolet Selling Agreement herewith being entered into,
>
> (1) warrants that the following constitutes the management, the entire direct and indirect ownership, and the current capital status of the dealership, any deviation from which shall constitute sufficient cause for the immediate termination of said Selling Agreement by Seller, pursuant to the provision thereof entitled 'Termination for Cause'".

If the Court please, I think what I would like to do

is make a picture of this in our office during the noon or later, and then offer it into evidence.

Any objection?

MR. PESTER: I haven't seen that, have I?

MR. FREED: Oh, you haven't? I thought you did.

THE COMMISSIONER: Yes, you may offer a photo-[fol. 64] static copy of that, Mr. Freed.

MR. FREED: I might just make reference—

THE COMMISSIONER: To what it is, to the document? The one you are now going to offer?

MR. FREED: The document is entitled "Minimum Capital Standard Agreement General Motors Dealers Capital Standard Program."

THE COMMISSIONER: Does it have a date on it?

MR. FREED: There is a date, yes, an execution date. The 1st day of November, 1954.

I will call attention to paragraph 1, which sets forth the minimum capital requirements.

• • • •

MR. FREED: Q. Mr. Gilmore, if the demands made by Dixie Gilmor were met by you, what would have happened to the minimum capital structure of Don Gilmore?

A. Well, it would have gone far below General Motors' [fol. 65] standards for that dealer.

• • • •

Q. If Dixie Gilmore had succeeded in obtaining all of the community interests which she claimed existed in the stock of the automobile dealership corporations, what effect would that have had on your ownership and control of those corporations? Do you understand the question?

• • • •

[fol. 66] THE WITNESS: Well, had the Court done that, my agreement with Chevrolet Motor Division and with the Pontiac Division would have been cancelled, because I could not have kept up the capital standard requirements required for any one of those three dealers.

MR. FREED: Q. What would have happened to you?

A. I would have been out of business.

Q. Would you have lost your jobs with those corporations?

A. Oh, yes.

Q. Could you get a job somewhere else?

A. Well, at my age I don't think so.

Q. Let us say, if Dixie had gotten half of what she claimed to be community interests?

A. The result would have been the same.

Q. Suppose she had gotten one quarter of the community interest?

A. Well, I can't say as to whether one quarter of the community interest would have lowered me below the then capital requirements required or not. I don't know.

• • • •

[fol. 67] MR. FREED: Q. Was there any other work that you could have done, that you could have qualified to do, if you had lost your jobs with those corporations, Mr. Gilmore?

A. Well, the automobile business has been my life work, but any other automobile dealer hiring would not consider a man my age.

• • • •

MR. FREED: Q. If you had lost the General Motors' franchise, Chevrolet Motor Division, was there any other business your corporations could have done that would have produced dividends on the stock which you had in the corporation?

A. No.

MR. FREED: No further questions.

[fol. 68] CROSS EXAMINATION

MR. PESTER: Q. Mr. Gilmore, did the capital requirement of the corporation under your franchise increase as the years went on?

A. It did.

Q. In 1954 the capital requirement was greater than in 1953?

A. I can't answer that directly. They usually revise them about every two years.

Q. Well, then, let's say in 1952 the capital requirement was less than in 1954?

A. I believe so.

Q. Then the amount shown here as the capital requirement under this document dated November 1, 1954, would not control with reference to the year 1952, when the divorce action was instituted?

A. I can't answer that, because I didn't know whether they changed the requirement in that two-year period or not.

MR. FREED: I might say, Mr. Pester, that this was the only Dealer-Seller Agreement we were able to find. That is the reason we are using it.

MR. PESTER: Q. I believe you testified, Mr. Gilmore, that you made an effort to reconcile your difficulties with Dixie Gilmore in 1952, prior to the time that the divorce action was instituted?

A. That's correct.

Q. She had gone down south?

[fol. 69] A. Yes.

Q. You worked through friends?

A. Not only friends, but the long distance phone.

Q. Did you see her after that?

A. Oh, yes. She came back to the house. I met her at the airport.

Q. About when was that in relation to the time that she instituted the divorce action?

A. I would say not over ten days.

Q. Did you see her after she left the house?

A. She didn't leave the house, sir, I did.

Q. You left the house?

A. That's right.

Q. Did you see her after that?

A. No.

Q. I believe you testified that after the divorce suit was instituted you made no effort or attempt to reconcile your differences with Dixie?

A. That's correct.

Q. Did you also testify that you didn't ask your attorneys to attempt a reconciliation?

A. That's correct.

• • • •

[fol. 70] REDIRECT EXAMINATION

MR. FREED: Q. Mr. Gilmore, you paid fees to attorneys, Mr. Freitas, did you not?

A. I did.

Q. Mr. Haun?

A. I did.

Q. Mr. Myers?

A. Yes.

Q. You paid other amounts out, did you not? Court reporters' transcripts?

A. Yes.

Q. Printing briefs, et cetera?

A. Yes.

Q. Did you have any quarrel with the amounts that you paid out? Were they reasonable, or not?

A. Are you referring to attorneys' fees?

[fol. 71] Q. The amounts that you paid.

Q. Are you referring to attorneys' fees?

Q. Let's take attorneys' fees first.

A. I felt they were reasonable.

Q. All the other expenses I have mentioned to you?

A. Well, of course I have no means of judging what I was charged for a transcript. It seemed very high.

Q. What about Mr. Schwerin?

A. Mr. Schwerin's fee was reasonable for a Certified Public Accountant.

Q. Do you remember what you paid him?

A. I do not.

MR. FREED: No further questions.

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[fols. 72-73] • • • •

[fol. 74] MONDAY, OCTOBER 26, 1959—
2:05 P.M.

WALTER F. FREITAS, a witness produced on behalf of the plaintiffs, having first been duly sworn by said Commissioner, was examined, and in answer to interrogatories testified as follows:

THE COMMISSIONER: Will you give your name for the record.

THE WITNESS: Walter F. Freitas.

THE COMMISSIONER: Mr Freitas, where do you live?

THE WITNESS: I live at 50 Lochinvar Road in the City of San Rafael, California.

THE COMMISSIONER: All right, Mr. Freed.

DIRECT EXAMINATION

MR. FREED: Q. Mr. Freitas, you are an attorney at law licensed to practice in all of the courts of the State of California and have been such for many years, have you not?

A. Yes, since November 1st, 1938.

Q. Your office has been and now is in Marin County?

A. Yes.

Q. Were you engaged by Mr. Gilmore to represent him in a divorce case entitled "Dixie Gilmore vs. Don Gilmore," filed in the Superior Court of the State of California in and for the County of Marin?

A. Yes.

Q. Are you able to state—do you have some office [fol. 75] records with you? I notice you are looking at something there.

A. Yes, I have a photocopy of our ledger showing the amounts and times of entries of charges for fees and for costs advanced, et cetera, and payments made in connection with the account of Don Gilmore.

Q. Without regard to those records for a moment, do you remember approximately when it was that you first got into the case?

A. Well, of course, my memory has been refreshed by looking at those records. I don't think at first I could have recalled the particular year, but I know now that it was during the year 1952.

Q. You were associated with Michael Harn, were you not?

A. That is correct.

Q When you got into the case, were you paid a retainer by Mr. Gilmore?

A. Yes.

Q. But that was in 1952 that you were paid a retainer?

A. Yes.

Q. What was the amount?

A. $500.

MR. FREED: I don't claim that that is material here; I just wanted to establish a pattern.

Q. After you got into the case, did you have conferences with Mr. Gilmore and Mr. Haun?

A. Yes.

[fol. 76] Q. Did you participate in any negotiations for settlement with the attorneys for Dixie Gilmore?

A. Yes.

Q. Were there any negotiations for settlement that you engaged in shortly after you got into the case?

A. If I understand your question correctly, were there any negotiations for settlement shortly after I got into the case?

Q. Yes, by you.

A. Yes, there were.

Q. Would you tell us about them, if you remember.

MR. PESTER: I would like to have him fix the time approximately, at least, and who was present.

THE WITNESS: All right, I will endeavor to do that, sir.

MR. FREED: That is well taken.

THE WITNESS: It was in 1952, during that year. The date there specifically, I don't know, except that I learned upon looking at our records since I was apprized of the fact that I might be asked to attend here that it was in June of 1952 that we first became associated with Mr. Haun in the case.

Within a few days of that, I called Mr. Charles Christin, whom I had known before, and who I knew then to be the attorney for Mrs. Gilmore, along with Les Gillen. I called Charley Christin and stated that we had been associated on behalf of Don Gilmore with Mike Haun, and that I stated further that we had been associated speci-

[fol. 77] fically for the purpose of trial, because it appeared that the case would not be settled, and the parties would not be reconciled.

I said I would like to come over and talk to him about possible settlement. I believe that I had been told by Mike Haun, or from some other source, one that I cannot exactly remember, that there had been some friction between the attorney for Mr. Gilmore and the attorneys for Mrs. Gilmore. I thought perhaps since there wasn't any friction between me and the attorneys for Mrs. Gilmore, that it might be well to try once again.

A meeting was arranged, and it was attended. It was held in Charley Christin's offices. I would say it was sometime in the latter part of June, 1952, and it was attended by Charley Christin and Les Gillen and myself. Nobody else was present.

The place was Charley Christin's office, and that is the best I can do on the time. I don't know if that answers the question, if I was asked to—

MR. FREED: Q. That is enough foundation, I think. Would you tell us what services you rendered in respect to those negotiations; what was said, what demands were made, if any, what responses you made, et cetera?

A. Well, in very brief summary, the meeting itself, I suppose, took a half hour to an hour. The essence of it was that I said, "I understand you fellows have been unable to get together with Mike Haun and settle this [fol. 78] case. It's too bad that it can't be settled. Don Gilmore is a prominent person and the type of personality that the newspapers would like to be able to write about, and we always prefer to settle these cases than try them. Isn't it possible that we can get together? If you fellows want to be reasonable, I think we are prepared to tell Don Gilmore to be reasonable, and maybe we can settle this thing amicably."

They liked that. They said they welcomed the suggestion, indicated that they would be very happy to settle it, but that thus far nothing reasonable had been submitted.

I said,

> "Well, of course, you realize I have just come into the case and I don't know very much about it, but if you will tell me what you think is reasonable, I will take that offer back and consult with our client

and make recommendations to him concerning it, and maybe we can accomplish something."

They then told me that they had information to the effect that at the time when Don Gilmore married Dixie Gilmore his financial net worth—and this is a matter in which I have not refreshed my recollection, so this is purely memory—Don Gilmore's net worth then was told to me by Charley Christin and Les Gilfen to have been somewhere in the vicinity of $160,000 or $120,000. As of a date which was about six years before this, as I remember, because they were married in '46, and this was '52. Contrasted with that, his then current financial net [fol. 79] worth was approximately $800,000, perhaps a little bit over, perhaps a little bit less, but those are the figures that I have in mind, with a difference of approximately $600,000 between what he was worth at the marriage and what he was reportedly worth now at the time of the prospective divorce trial. They felt that this was money which he had earned since marriage, and therefore was community property. They felt Dixie Gilmore was entitled to one half of it, and for purposes of a cash settlement they would discount her 50% of that difference down to a figure of $275,000.

They told me at that meeting that if Don Gilmore would pay Dixie $275,000 in cash, she would waive all claims of alimony, attorneys' fees, court costs, et cetera. They would settle for one lump settlement figure.

I said,

> "Well, most of what you have told me is news to me. I don't know what his financial net worth is now, nor do I know what it was then, but your theory seems plausible and acceptable. If those facts are true, I don't think I can disagree with you. Let me go back and do a little research and find out if those figures are correct."

That was the end of that meeting.

Then I went back to Mike Haun, and I can't remember now whether Don Gilmore was in on that first conference or not—probably he wasn't but as I remember it I went

[fol. 80] back to Mike Haun's offices and I told him briefly what had happened. Then we set up a meeting at which Don Gilmore was in attendance.

I told him that I would like to get into these fiscal matters myself and find out what his balance sheet was as of the date of the marriage and was now, and to try to trace the acquisition of the additional wealth, to see whether it was actually a change of properties, or whether it was simply an appreciation of values of the same things.

I was introduced then to Mr.—I am sorry, I don't know the spelling of his name, but we called him "Mack", and it was McCullough, or McCullen—

MR. FREED: McCullough.

THE WITNESS: He was the general manager of the Don Gilmore offices on Van Ness and Golden Gate, and Don Gilmore told Mack to give me whatever information—

MR. PESTER: I was going to object on statements made between the parties as being immaterial.

THE COMMISSIONER: It wouldn't be admissible, of course, to prove the facts. It would be admissible only to show what the attorneys did. It would be part of the chronology, not to prove the truth of the facts. Go ahead, Mr. Freitas.

THE WITNESS: Gilmore instructed his manager to make available to me any and all data that he had that I might request, which is what I wanted to see, so that we wouldn't have to have Don Gilmore there at every meeting.

[fol. 81] Then, McCullough and I had numerous conferences from day to day on these details of the source of income and assets, and I also recall that I asked him to get me a chart of every check that was written by Don or Dixie Gilmore, not in the business, but in their personal accounts, and to identify the purpose of that expenditure, and to post it to a certain column that would indicate, for example, if it was for food or if it was for steamship tickets, or if it was for clothing or something else. We had a few columns like that where we placed these different expenses in various categories.

As a result of that compilation of data, I came to the conclusion that this couple had expended so much money in their necessities and luxuries of living. I was approaching it on the theory that we had commingling of funds here that came out of the community and out of the separate estate, and I wanted to try to see which had been preserved and whether one had made inroads into the other, and to see what segregation, if any, there should be now made as to his net worth; whether it was all separate or some part separate, and some part community, or conceivably all community.

As a result of these many meetings with McCullough, and the information that he was helpful in providing, I came to the conclusion that—first, I should go back a little bit—I forgot something there that I think is pertinent. There was a matter of what was community income since the marriage, and I tried to differentiate and allocate that. I recall that, and this has not been re-[fol. 82] freshed with reference to any memorandum or data at all. This is just in my memory. In his income tax returns, Don Gilmore had been stating, I think, $50,000 as his salary from the dealerships. There was a question: Is that reasonable?

I learned that Jimmy Waters in San Francisco, another prominent automobile dealer, was being paid the same from his corporation, and that this was the largest amount that was tolerated by the Internal Revenue Service for services of this kind. So, more or less feeling then that that was reasonable as salary, we credited the community estate with that income. Then, making the computations that resulted in the conclusion that more money had been spent by Don and Dixie Gilmore in the enjoyment of their personal community living than had been earned by Don Gilmore and credited to the community estate. It appeared to me that it was sort of a matter of insolvency of the community estate, and I came to the conclusion and told Mike Haun and McCullough and Don Gilmore that I thought there was no community estate left; that whatever was there was the result of appreciation in value of franchises of the dealerships which we had seen in other instances during that period immediately post war, and

that I felt that while there had been substantial community income, they had taken several trips—as I recall there were trips to Europe, and I have forgotten where else—that they had lived it up, let's say, and spent quite a bit of money. There was no argument forthcoming from [fol. 83] any of these fellows, and there was apparent unanimity of agreement among us, at least, that this was so.

Then I was authorized and instructed to go back and convey that message to Messrs. Christin and Gillen, which I did.

I called Mr. Christin and had another meeting, at which Mr. Gillen also attended, and I told them just in review what we had talked about some thirty days or so earlier, and what I had done since then, and what I had found, I thought, by way of application of legal principles to the data that had been submitted to us. I told them that in the best of my opinion there was no community estate. All that was there was separate estate and Dixie Gilmore had no right by way of proprietary interest, at least, in any of that. None-the-less, because there was a controversy, and although we felt that she would be determined to be the guilty spouse, and therefore we felt she was not entitled to any alimony under the laws of our State at that time, none-the-less I had recommended to Don Gilmore, and he ultimately agreed, that she be paid the sum of $10,000 as a compromise of their total differences.

Well, this suggestion wasn't very well received by opposing counsel, and that just about terminated the negotiations for the settlement. They refused, and they said,

"We'll go to trial."

Then, they began to take depositions, and ultimately we withdrew from the case and Mr. Myers tried it. We were not in the case at the time of the trial.

[fol. 84] I think that is about all I can think of in the summary of what was done toward negotiation for settlement.

MR. FREED: Q. During this period of time, did you make any efforts or were any proposals made to you that there be a reconciliation?

A. No, I don't recall that subject ever having come up again after Mike Haun told me, even before I met Don Gilmore, I think—well, I mentioned something about reconciliation, which is usually our first thought, and he said,

> "No, we're past that, and we're also past compromise, even."

I don't recall any talk by me with any of Mrs. Gilmore's attorneys concerning possible reconciliation.

Q. You were still attorney in the case, were you not, when the Second Supplemental Complaint was filed by Dixie, charging Don Gilmore with adultery?

A. Well, it would help me if you would give me that date. I don't recall when it was filed.

Q. The Clerk's Transcript notes that the Second Amended Supplemental Complaint was filed December 23rd, 1952.

A. Yes, we were still in the case at that time. I think it was about the following May that we withdrew from the case. That is subject to confirmation by looking in our file. I am just talking now from memory.

Q. What was the essence of the dispute or the fight, so far as you were concerned, in rendering services to Mr. Gilmore?

[fol. 85] A. I think it was clearly this contention that she was the owner of one half of the difference between his financial net worth as of the date of the marriage and as of the time of the divorce proceeding, which was 1952. Her attorneys were claiming that she was the owner of one half of that increase in his financial net worth on the theory that it was property acquired during the marriage.

Q. What about the alimony? She was claiming alimony too, wasn't she?

A. Well, I am sure the Complaint sought it. It was mentioned without particular emphasis in our early discussions with attorneys for Mrs. Gilmore, and I am sure that it wasn't being waived.

It was not very prominent in the discussions, and when we talked settlement, there was the explanation by them that this $275,000 lump sum payment would, if made, mean that they would waive alimony. We likewise, when we

made a counter-proposal of $10,000, had the understanding that there would be no alimony beyond the lump sum payment of $10,000, which was the settlement figure to cover any property interests that she might have, plus any alimony, plus attorneys' fees, and the other things embraced within the pleadings of her Complaint.

Q. I believe you have already stated that you received $3,500 from Don Gilmore in 1953 as attorneys' fees?

A. That's right.

[fol. 86] MR. PESTER: What was that last question?

THE WITNESS: I don't think I stated it, but I think that is right.

THE COMMISSIONER: Read that last question and answer.

(Record read)

MR. PESTER: I want to object to that.

MR. FREED: Wasn't it stated?

MR. PESTER: No, sir.

MR. FREED: I am just imagining it.

THE COMMISSIONER Mr. Freitas, did you state that earlier you were paid a retainer, but you didn't state how much?

THE WITNESS: That is correct. I don't think I had been asked what the amount was, if any, that had been paid in 1953.

MR. FREED: I thought somewhere in the questioning that had crept in. That is not material.

Q. Do you know how much you received in 1953?

A. Yes.

THE COMMISSIONER: You have a record of it there; do you, Mr. Freitas?

THE WITNESS: Yes.

THE COMMISSIONER: Those are your office records?

THE WITNESS: Yes. On May 1st, 1953, the entry says "Balance, fee, $4,500."

Then, on September the 8th there is another entry here which says, "Fee allowance $1,000."

[fol. 87] September 14, I think it should be—this says 4, but I think it was subsequent to the 8th—$3,500 was paid.

Actually, what happened there, by way of explanation of what appears to be sort of a discrepancy, when we notified Mr. Gilmore that we wished to withdraw, we entered the final fee of $4,500. He, in subsequent correspondence, felt that that was too high, and there were some negotiations which ultimately resulted in our agreeing to reduce our total fee, including a $500 retainer paid in 1952, from $5,000 to $4.500, if he were to pay all of this at that time, and then we gave him the option of if he wanted to go borrow the money he could save $500 and pay us, instead of $4,500, or instead of $4,000 more, if he would pay us $3,500 more in cash we would agree to that. He chose the latter of those two options and paid us $3,500 on or about September the 4th or 14th, 1953.

Q. In your opinion, was this a reasonable charge for your services?

A. I thought it was a little bit low, myself, but that was agreed.

• • • •

[fol. 88] Q. Can you state how much of the fee you [fol. 89] charged, what proportion of the fee you charged, namely, $3,500 in 1953, is attributable to the services rendered which you described in reference to the so-called community interest in the stock of those corporations?

• • • •

THE WITNESS: I would like to qualify that by stating that never until today was there any effort made to separate that issue from the other issues at all. I wasn't conscious of that as we went along, so I don't know how good an estimate this will be. Just for purposes of whatever light it may shed, it is true that what we were concerned with at the time was this matter of—going back a little bit to something I think I should have mentioned, which I didn't, when they said "$275,000 cash," I said, "Well, Don Gilmore doesn't have $275,000 cash, and I don't think he can raise $275,000 cash." Whereupon they said to me, "Oh, that's all right, we'll take stock in his corporations in lieu of cash."

Of course, that was something that we couldn't tolerate on behalf of Mr. Gilmore. We didn't want Dixie Gilmore

as a stockholder in this corporation with him. I think that by far, perhaps something in the neighborhood of 90% of our concern was to forfend against this property claim, and the alimony thing didn't bother us too much, because [fol. 90] I had already learned enough to what we thought was misconduct on behalf of Mrs. Gilmore so that I wasn't apprehensive that she was going to get any large sum of money for any long period of time as alimony. I thought that if we had to we could prove a lot of misbehavior on her part that we didn't want to have to prove if we could settle the property interest question. The alimony was sort of something that went along behind the dog, so to speak, and it wasn't the major issue at all. It was by far the minor issue and received very little attention, I might say.

MR. FREED: No further questions.

## CROSS EXAMINATION

MR. PESTER: Q. Mr. Freitas, how much was the total fee that you received?

A. Well, I brought copies of this. If this would be of any assistance to anybody, and I thought perhaps you would like one, and each side would like one, it shows the total fee, in answer to your question, was $4,000. There was $500 on June 16, 1952, and $3,500 in September of 1953.

Q. That thousand dollars that you mentioned on September 8, how did you classify that?

A. Well, it is listed here as "fee allowance." That was really a write-off of a thousand dollars. You see, originally we entered a retainer of $50. When we were withdrawing and I wrote the letter to Mr. Gilmore, I rendered our final statment of $4,500 in addition to the $500, or a total fee [fol. 91] of $5,000. At least a month, or perhaps longer than that after that—

MR. PESTER: I am not interested in the details.

Q. Then, when Mr. Gilmore complained about the size of your fee, you knocked off a thousand dollars and just gave credit, and that is what you call an allowance?

A. Yes.

Q. Who paid that $500 retainer to you?

A. I frankly don't remember, sir, whether it was paid in the mail or whether it was paid by Mike Haun, or whether it was paid by McCullough. I can't answer that.

Q. I thought you had testified that had been paid to you by Haun. Am I mistaken that that was your testimony on direct examination?

A. I don't believe I so testified, because I don't usually testify unless I have a better recollection of it than I have of that. I don't remember who paid it to us. My file might disclose it, if it is important.

Q. That was included in the $4,000 of your fee?

A. Yes.

Q. You received that amount before you did any work in connection with the case?

A. Well, any substantial amount of work. We may have had a small conference or two, but I would say that this was right at the outset, yes.

Q. That is more than 10% of the total fee that you got [fol. 92] in the case, isn't it?

A. Well, it so appears now, by that computation, yes.

Q. What I am getting at is that now you are attempting to say that 90% of your efforts were devoted to the community issue—

MR. FREED: That is not quite right. I object to that.

MR. PESTER: Q. (Continuing)—whereas—

THE COMMISSIONER: Wait a minute.

MR. PESTER: Q. (Continuing)—you received $500 before you knew very much about the case?

A. Yes, I still say that. It might very well have been that we spent the entire time on the property issue alone, without any consideration of alimony, and still the fact that a $500 retainer fee was paid in advance of any substantial performance of services, I think, doesn't indicate for what purpose or purposes the services ultimately rendered were performed.

Q. The divorce action and the nature of the acts which involved adultery wouldn't warrant an allocation of more than $500 to the other $4,000, in your opinion?

MR. FREED: Just a moment. I wish to object to that, really. There has been no allocation made of $500; just an

allocation of the $3,500 as far as this case is concerned. Isn't that correct, Mr. Pester?

MR. PESTER: I don't know.

MR. FREED: It is only 1953 that is involved, not 1952, when the $500 was paid.

[fol. 93] THE COMMISSIONER: Let's go on to the $3,500 basis.

THE WITNESS: I am sorry, I think I will have to have the question read.

(Reporter read the last question)

A. I wouldn't say that that is my opinion, Mr. Pester, no. In other words, the proof and the consideration of the legal contest of the adultery were part and parcel of the property defense, as well as matters, for example, related strictly to alimony, because the Court, who would be dividing any community property which it might ultimately find there was, would have a right and perhaps a duty to take into consideration the conduct or misconduct of each of the spouses when it came to exercising any discretion which the law gave to the Court in the matter of awarding 50% or more of the community property. Even if she had waived alimony initially in the filing of her Complaint, we still would have been concerned with evidence and proof of the issue of adultery, because even if there were no question of alimony, whether Don Gilmore had been guilty of many adulteries or none would have been an issue that we would have to fight on the protection of the separate estate.

MR. PESTER: Q. The alimony question remained in the case so long as you were in it?

A. Yes.

Q. You made no separation of the work that you did during the course of your employment?

[fol. 94] A. That's correct.

Q. What did Mr. McCullough do with respect to the automobile companies in the making of charts that he showed to you?

A. My memory is that he didn't do this personally, but he had it done by someone else, some accountant or bookkeeper, somebody whose name and whose identify I have

forgotten. I don't think that McCullough, himself, did this work.

Q. Let's forget whether Mr. McCullough did the work or not. Do you know how many charts he showed you?

A. No, I don't. They weren't so much charts. Perhaps I haven't been properly understood. They were in the form of charts, perhaps. They were simply postings. In other words, we had over here in this column the date, the payee, the amount, and then what it was for. Then we had a determina of whether it was community or separate. Some of this would be prepared, the checks, the listing of checks, probably by—well, a 15-year old girl could have done that. It was simply copy work, you see, to list these checks out. That data, just by going over the cancelled checks that could be obtained, what it was for, was something that we frankly had to consult Don Gilmore about, because McCullough wouldn't know what it was for. I certainly wouldn't know, and Mike Haun wouldn't know. Sometimes Don Gilmore wouldn't know at first, without refreshing his memory on it a little bit. Ultimately there would be a determination. Whether it was right or wrong, of course I don't know. We determined it as best we could, [fol. 95] what that check was for, and it may have been for flowers for Dixie in Florida. I don't know that. I couldn't tell what they were for. Then we had to depend on him in those instances.

Q. What period of time did that cover?

A. The period of the marriage, sir.

Q. The period of the marriage?

A. Yes.

Q. All three of the automobile companies?

A. No. I thought that I said in my testimony that these were not checks of the automobile companies. It may be the same period, I don't recall the period of the companies, but these were not the company checks.

Q. These were personal checks?

A. Yes.

Q. None of these checks were payments by the corporation to—

A. Well, I couldn't say that that is true. No, it could very well be. This was six or seven years ago, and it could

very well be that some checks—it does seem to me that a lot of personal expenses were paid by McCullough or by the company for Gilmore, and then charged back to his drawing account, or something like that. In fact, some of these checks may have been paid by the corporation. I don't have a distinct recollection of that one way or the other.

The idea was to take expenditures on behalf of this [fol. 96] couple. We weren't concerned with whether they spent money in the corporation in the conduct of their business. We didn't audit the corporations' expenditures.

Q. What I am trying to find out is just what you did in connection with property. What you did was to analyze the personal expenses of the Gilmores during their marriage?

A. That is part of what we did, yes, sir.

Q. And you concluded that more money had been spent by the Gilmores than he had earned from these corporations by way of salary?

A. Yes, sir.

Q. Who worked with Mr. McCullough directly, so far as the attorneys were concerned?

A. I think after I came into the case I worked with him, more than Mike Haun, but I know that Mike worked with him. They were closer in distance to each other than I was. In my opinion, which might be erroneous, I think that I spent more working hours with McCullough than Mike Haun, although I think much of the time that I was there Mike Haun was there too. Perhaps that first conclusion of mine is erroneous. If he was there—I mean, he wasn't really conducting the meeting with McCullough as much as I was. I was telling McCullough what I wanted, and we were reveiwing these checks and ascertaining this data. I suppose Mike Haun was there almost every time I was there. I can't remember that very well.

Q. You were really carrying out as the manager of the [fol. 97] three of you then? In other words, you were asking what data was to be furnished and directing Mr. McCullough, rather than Mike Haun?

A. I would say so, yes.

Q. You said something about depositions having been taken. Can you tell something about those depositions?

A. A little bit.

Q. What did they involve?

A. Well, they involved Mr. Gilmore's testimony. He was being interrogated by Charley Christin in Charley Christin's office. Of course, he was under oath; there was a Court Reporter there; and they were quite lengthy.

I recall that Charley Christin had a large book, a bound volume, from which it appeared to me, at least, because he never showed it to me, that it was a private investigator's report, and a transcript of bugged conversations principally.

I recall that it had—you are asking me what I recall about it—Charley Christin would look at this book, this bound book, and then he would say to Don Gilmore:

> "And then did you say to her something substantially like this,"

and then he would ostensibly read from it, to let us know that he had a verbatim report of this conversation. These interrogations involved Mr. Gilmore's answers. It involved admonitions on my part to him not to answer upon one of two grounds: No. 1, that these reports were aimed [fol. 98] primarily at conduct allegedly occurring since the date of the filing of the Complaint, and therefore it was not within the issues framed by that Complaint. This was prior to the filing of the Supplemental Complaint. I would frequently, whenever I though it was proper, tell Mr. Gilmore that "You don't have to answer that since it relates to a time which is subsequent to the date of the filing of the Complaint," and until they filed a Supplemental Complaint that was within the issues before the Court. That was one ground of objection.

Then, on some occasions, I also urged him to refuse to answer upon the grounds that it might tend to incriminate or to degrade him.

Q. About how long did the taking of those depositions last? How much time did that involve?

A. I know that it wasn't completed in one day. I know that there was—I know this much further about it: There

was disagreement between M.. Christin and myself on some of these questions, as to whether the witness had to answer them, and he certified certain questions to the Superior Court, under the provisions which we have in this State. When you are taking a deposition and there is no judge there to overrule the objection or admonition of witnesses' counsel that they need not answer, then, as was done in this case, Charley Christin went into the Superior Court with certain specific questions which Don Gilmore had not answered, and then requested the Court to certify them and send them back.

[fol. 99] Q. Did you participate in the Appellate action with reference to those?

A. No. My office did, but I didn't.

Q. What do you mean by your office?

A. Well, we have—

Q. Another attorney in your office?

A. Yes, we have partners and associate employees. I was then involved by Court appointment in a long jury murder case, right in the fall of '52, and I couldn't be at both places. I sent one of my partners over to attend to a lot of these things that were concurrently going on.

Q. That work was included in the payment that you received which you have testified to here?

A. Yes, sir, any work done by any lawyer in our office for Mr. Gilmore was all included in this one. This is the only account we have had with Mr. Gilmore.

Q. Did you prepare any Briefs in the case?

A. No. When I said Superior Court, that is the trial court, not the Appellate Division.

Q. Did you keep a record of the work that you did in connection with the case?

A. I didn't myself keep a time sheet. I know that I saw today—I didn't read it—a time sheet kept by a partner of mine who did some work in this case for me. I didn't keep one myself.

Q. You didn't keep a time sheet for the work that you did?

[fol. 100] A. That is correct, I did not.

Q. With reference to this book that he had, and the depositions that were taken which you testified to, all of that pertained to conduct of Mr. Gilmore?

A. Well, I would think that all that was in the book pertained to his conduct, but some of the questions would go beyond that. In other words, during the course of a day's interrogation there would be departures from the reading of the terminology before him, and there would be extemporaneous questions, and then there would be a return to that.

Q. Yes, but generally speaking it pertained to Mr. Gilmore's conduct?

A. Yes.

MR. PESTER: I believe that is all, Your Honor.

MR. FREED: That is all.

THE COMMISSIONER: You are excused, Mr. Freitas.

HENRY J. McCULLOUGH, a witness produced on behalf of the plaintiffs, having first been duly sworn by said Commissioner, was examined, and in answer to interrogatories testified as follows:

THE COMMISSIONER: If you will give us your name for the record, sir.

THE WITNESS: Henry J. McCullough.

THE COMMISSIONER: Where do you live, Mr. McCullough?

THE WITNESS: Oakland.

THE COMMISSIONER: You may examine, Mr. Freed.

[fol. 101] DIRECT EXAMINATION

MR. FREED: Q. You are in the automobile business, Mr. McCullough?

A. Yes, sir.

Q. Do you remember how long you have been in the automobile business?

A. 37 years.

Q. Were you employed at one time by Don Gilmore San Francisco?

A. Yes, sir.

Q. A Chevrolet dealer?

A. Yes, sir.

Q. What was your position with that company?

A. In the final years I was vice president and general manager.

Q. In 1952 and 1953 what was your position with the company?

A. I was vice president and general manager.

Q. You know Don Gilmore, and, of course, you knew him at that time?

A. That's right.

Q. Did you have any connection with Don Gilmore Hayward, a Chevrolet dealership there.

A. Yes, sir, I did.

Q. What was your connection with that company?

A. I was a stockholder and officer of the corporation.

Q. Did you have any connection with Don Gilmore [fol. 102] Riverside, a Pontiac automobile dealership?

A. Yes, sir.

Q. What was your—

A. Stockholder and officer of the corporation.

Q. For how many years have you been connected with a General Motors dealership, more specifically Chevrolet?

A. Using Chevrolet since 1933.

Q. Are you familiar with the Chevrolet Motor Division form of contract of General Motors Corporation with dealers?

A. Yes, sir.

Q. The franchise, or contract, is called, is it not, a Direct Dealer Selling Agreement?

A. Yes, sir.

Q. You have had experience in the dealer relationship with General Motors, have you, in reference to that Direct Dealer Selling Agreement? Have you had some experience?

A. Yes, I have.

Q. Do you know what the General Motors policy, General Motors Corporation policy, has been with respect to allowing a wife, for example, of a dealer to own stock in a corporation?

A. Well, I can give you my personal opinion.

Q. Have you had any personal experience, or have you had any observation or knowledge in respect to it?

A. I have had observation both ways, incidentally.

Q. Will you state what they are?

A. Well, one is that they have allowed one dealer's wife [fol. 103] to continue under certain restrictions. That is in Richmond, incidentally, Claare Chevrolet there. Other dealerships, where the wife became heir to the stock of the corporation they have suggested in those cases a reduced amount of ownership, leaving the control in the hands of the new dealer that had been accepted and appointed by Chevrolet to continue the business.

Q. Referring to that Richmond situation, is that a situation in which there is a widow involved?

A. It was originally, yes.

Q. Was she allowed to remain on as the dealer?

A. Yes, she has been.

Q. Still is?

A. Continued, and still is.

* * * *

[fol. 104] MR. FREED: Q. Do you have any knowledge from your observations or experience to which you can refer on the subject of whether specifically Dixie Gilmore, under the contract that Don Gilmore San Francisco had with the Chevrolet Motor Division, could have been a stockholder?

A. Well, the only opinion I can give, I know how Chevrolet Motor Company felt toward the whole case, which had reference to Mr. Gilmore and Dixie Gilmore, of course, in the divorce action.

Q. What was the Chevrolet Motor Division's attitude toward the case, if you know?

A. Well, they certainly weren't very pleased about the whole situation, and various individuals within the framework of Chevrolet at the zone level expressed themselves [fol. 105] as not being too happy about it, in my presence.

Q. Does that have any meaning from the business standpoint?

A. Well, it would have the meaning to the extent that I said a moment ago, that I doubt very much from my knowledge that Dixie would be an acceptable applicant for any portion of an ownership in any dealership that they were issuing a franchise for.

Q. If Mr. Gilmore had lost control of the corporations in which you were interested with him as a stockholder,

that would be Riverside and Hayward, would he have been continued as a salaried employee by those corporations?

A. I believe he would have been continued as a salaried employee, under certain restrictions, of course, not as a controlling interest in the business but in proportion to his investment in the business, whatever it may have been.

Q. Would his salary have been changed?

A. I am sure that the salary would have a downward change. There is no question about that.

Q. In other words, the salaries would have been reduced; is that what you mean?

A. Reduced because of the reduced control in the business, naturally.

Q. As the general manager of Don Gilmore, San Francisco, if Mr. Gilmore had lost his Chevrolet franchise, or if the corporation had lost its franchise with Chevrolet Motors Division, is there any other automobile for which [fol. 106] they could have gotten a franchise? Do you know?

A. Well, that would be highly speculative, because it would be just a question of how strong you went after a franchise and the type of franchise that he would have represented. That, you might say, would be a franchise as profitable or as good as a Chevrolet franchise.

Q. Could Mr. Gilmore have continued to earn the salary, as big a salary as he was earning at Don Gilmore San Francisco, if the franchise, the Chevrolet franchise, had been lost?

A. Well, I think that would have been measured as to the potential from the new franchise, whichever it may have been.

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MR. FREED: Q. You were familiar with the services he performed, Mr. Gilmore performed, for the Chevrolet dealership in San Francisco, were you not?

A. Yes, I was.

Q. Would you say that he was adequately paid for his services?

A. I believe he was.

[fol. 107] Q. Would you say he was generously paid?

A. I believe so.

Q. Could he have earned that much elsewhere, do you think, for the same amount of services which he performed?

A. Well, I could hardly say. You know, it all depends upon the type of business he is in and the organization he is representing. That would be up to them, to decide his capabilities, and what his earnings should be.

Q. Can you say that if Mr. Gilmore had not been the controlling stockholder he would have received as much salary from Don Gilmore San Francisco as he did? Let us say you controlled the company and you owned most of the stock in the company. Would he have received that kind of salary for the amount of work that he did?

A. No, I don't believe so. I don't believe he would have qualified for a salary comparable to what he had been receiving there for the services rendered and the investment in the corporation. It would have to be a little more equitably distributed.

Q. Was there a relationship between the stock ownership and the salary, Mr. McCullough? Did he receive that much salary because he owned all of the stock? Is that the idea?

A. Well, I don't believe that was the complete idea, because the man piloted the organization, of course, as you know, and that, in itself, has some compensation features.

MR. FREED: No further questions.

[fol. 108] CROSS EXAMINATION

MR. PESTER: Q. Mr. McCullough, what meaning did you give to the phrase "adequately paid," when you answered the question as to whether Don Gilmore had been adequately paid for his services?

A. Well, what I had in mind particularly, it was more or less a going compensation or income that was prevailing for a man in his position in a corporation the size of ours at the time.

Q. Do you know what he was paid?

A. I believe it got up to somewhere in the area of around $3,500 a month, if I am not mistaken.

Q. If he got more than that, it was—well, was that of all three corporations that you have reference to?

A. No, I have only reference to the San Francisco corporation.

Q. If it was more than that, he was getting too much?

A. Well, I wouldn't say he was getting too much, but I'd say it was adequate.

Q. You testified to the effect that the General Motors was a little bit concerned about the entire divorce action of Mr. and Mrs. Gilmore?

A. Yes, they were, and the publicity that had been given to it.

Q. Was that by reason of the moral issues involved?

A. Well, they didn't express what they had in mind in particular, but the whole case as a whole. It didn't fit [fol. 109] too well with their thinking at the time.

Q. That was with reference to Mr. Gilmore, as well as Mrs. Gilmore?

A. That's right, both ways.

Q. Where are you employed now?

A. I am with Don Gilmore Hayward, Chevrolet dealership.

Q. He still has that?

A. No, he has not. Gilmore is no longer in the dealership. He has no investment in it at all.

Q. I see. It just bears the name?

A. Carries the corporate trademark, yes.

Q. When did Mr. Gilmore get out of that?

A. The first of this year.

Q. Do you know Mr. Freitas, attorney for Mr. Gilmore?

A. Yes, I do.

Q. Did you work with him in the year 1952 with reference to determining the reasonableness of Gilmore's salary?

MR. FREED: Just a moment. I think that counsel is now making Mr. McCullough his witness, Your Honor.

THE COMMISSIONER: Yes. That was not part of the direct, and your observation is correct. As to this line of inquiry, Mr. Pester, this witness is yours.

MR. PESTER: For this, he can be my witness.

THE WITNESS: What was the question?

MR. PESTER: Would you read the question.

(Reporter read the last question)

[fol. 110] THE WITNESS: I don't recall that we had any discussion about the salary. I did work with the man, because he was an attorney representing Mr. Gilmore at the time. I believe he was the first attorney Mr. Gilmore had handling his case at that time.

MR. PESTER: Q. Do you know what you did in that connection?

A. With regard to the salary?

Q. Well, with regard to work that you did in conjunction with what Mr. Freitas wanted.

A. Well, Mr. Freitas, like all attorneys, asked for certain schedules and details and certain facts and figures that were necessary at the time. We prepared them. Of course, to remember exactly what they are, I don't.

Q. You prepared them, or you had them prepared by some of the workers in the office?

A. Various clerks or people that could put the information together.

Q. You received no additional salary for that?

A. No.

Q. That was included in the salary that you were getting, or your compensation, from the corporation?

A. That's right.

MR. PESTER: That is all.

MR. FREED: That is all.

THE COMMISSIONER: You are excused, Mr. McCullough.

[fol. 111] Counsel, we will take our recess now for about five minutes or so.

(Short recess)

THE COMMISSIONER Let the record show that a written stipulation which has been signed by counsel for both parties, dated October 26th, 1959, is now handed to the Reporter, in order that he may mail it in to the Clerk, along with the Transcript of Testimony in this case. In connection with the stipulation, there are a number of exhibits which will also be handed to the Reporter and which will accompany it.

* * * * *

[fols. 112-135] * * * *

[fol. 136] MONDAY, OCTOBER 26, 1959
—7:30 P.M.

WALLACE S. MYERS, a witness produced on behalf of the plaintiffs, having first been duly sworn by said Commissioner, was examined, and in answer to interrogatories testified as follows:

THE COMMISSIONER: Mr. Myers, we have your name, but give it to us for the record, anyway.

THE WITNESS: Wallace S. Myers.

THE COMMISSIONER: Where do you reside, Mr. Myers?

THE WITNESS: 1100 Sacramento Street, San Francisco.

THE COMMISSIONER: All right, Mr. Freed, you may examine.

DIRECT EXAMINATION

MR. FREED: Q. Mr. Myers, you are an attorney at law licensed to practice before all of the courts of the State of California?

A. Yes.

Q. And you have been such for a number of years?

A. That's right.

Q. You were engaged, were you not, by Don Gilmore to represent him in a case that was pending in the Superior Court of Marin County, California?

A. I was.

Q. Do you have any recollection of about when you were engaged by Mr. Gilmore?

A. Well, it was the early spring of 1953. Perhaps [fol. 137] January, February, along in there.

Q. At that time Mr. Gilmore had other counsel too, did he not?

A. Yes, he did.

Q. Do you remember who they were?

A. Well, Michael Haun was his attorney at that time, and he had, I believe, just released the office of Freitas, Freitas and—I don't know whether it was Allen at that time or not, but this was a firm headed by Carlos R. Freitas and Walter Freitas.

Q. Do you remember approximately how long before the commencement of the trial you were in the case?

A. Well, I would say it must have been a little over a month. My recollection is, I think it started some time in March, the trial, I believe, and I had been working on it for probably 30 to 60 days, somewhere in there.

Q. Do you remember whether you had any negotiations with counsel for Mrs. Gilmore in regard to the settlement of the case before the trial started?

A. There had been negotiations, but I don't believe I participated in any. I think they had concluded by that time that—I knew what in a general way had been suggested. I knew something of the demands of the plaintiff, but I didn't pursue it directly after I got into it.

Q. In other words, you personally did not participate in any negotiations before the trial commenced; is that right?

[fol. 138] A. Well, other than Mr. Haun, I think he spoke to Mr. Christin a time or two, but their demands had been, as I recall, in the neighborhood of 270 to 300,000, and it was completely out of the question as far as we could see, so we didn't figure there was any chance of settlement.

Q. Before the trial commenced, were any demands made on you—withdraw that.

After the commencement of the trial, were there any negotiations, to your knowledge, for settlement, in which you participated?

A. I don't recall any.

Q. In the preparation of the case for trial, did you have any dealings with Mr. Schwerin, a Certified Public Accountant?

A. Yes, I did. I told him what I wanted, and he prepared the exhibit for me.

Q. What was the subject of that?

A. Well, there were three automobile agencies, as I recall, three corporations, and these corporations had been formd shortly before the marriage of Mr. and Mrs. Gilmore.

I can only tell you roughly, but there had been an increment of something like possibly $600,000 or possibly more in the value of the stock of those corporations during their married life, and she wanted half of that. It was our contention that none of that was community property, and when I came into the case, Mr. Schwerin had gone through the books and had pretty well familiarized himself with it, [fol. 139] but the picture was not clear as to the community property if any, and the separate property, and I asked him to prepare a statement which would reflect all of the income that Mr. Gilmore had enjoyed from his salaries with the corporations. He had had a salary with each corporation, and I wanted him to reflect those salaries.

Then, I told him I wanted him to set forth all of the community obligations that had been paid during those years, because of the old Van Camp case and some other cases in California, in which it is presumed that all community debts are paid out of the community property. He went to work on that exhibit and prepared it, and it did, as a matter of fact, reflect that there had been more community expenditures than there had been community income, and then we were faced with the problem of whether or not the salary had been fairly fixed. We got evidence to that effect, but the exhibit indicated that there had never been any community property of any substance at all.

As a matter of fact, I think the exhibit showed that his separate property had gone into the acquisition of certain joint tenancy property in Marin County, including a home in Fairfax and one in Belvedere.

That exhibit, as I recall, was our Exhibit No. 4 in the case, and reflected that there was no community property.

Q. You had a fight in court of about 23 or 24 days, I understand?

[fol. 140] A. 24 trial days.

Q. In rendering your services and charging for them, what was your objective in behalf of Mr. Gilmore in that fight?

A. Well, his main concern was that he didn't want his stock bothered, his separate property disturbed. That was

what he considered to be his separate property in the corporations, and I guess that was my main objective, establish the fact that there was no community property and that all of the corporations, the increment, had been natural and had been a growth of private, separate capital and not community capital.

Q. Mrs. Gilmore asked for alimony, I believe, in her Complaint?

A. Yes, she did.

Q. Was that of any concern to you in representing Mr. Gilmore?

A. Well, in a sense, but we frankly didn't have much hope of getting by alimony. I mean, in a reasonable amount we didn't. It was more or less of what I might classify as a windfall when we won the case all the way, and the Court denied her alimony because it denied her a divorce.

Q. Was the issue of the joint tenancy houses, that is the home in which they lived and the other home which they had previously had in Fairfax, which stood in joint tenancy, an issue of any consequence?

A. Well, the Court considered the deeds. The deeds were in evidence, and, as I recall it, the Court concluded [fol. 141] it was in joint tenancy, and that he couldn't dispose of it as community property. I think he held it was a true joint tenancy. Sometimes they say that it is actually in joint tenancy, but is held as community property. I think that was held as joint tenancy property, and he didn't dispose of it or attempt to dispose of it, as I recall.

Q. There was no dispute that there was a co-ownership of 50% each in those?

A. Well, it was a joint tenancy holding, which reflected of record that they were equal owners. As a matter of fact, I think we traced a lot of his separate funds into that Belvedere home, at least.

Q. A great portion of the trial and of the Briefs on Appeal, Mr. Myers, had to do with the conduct of the parties, as I understand. Is that correct?

A. That is correct.

Q. In going into the matter of the conduct of the parties, whether it was gone into first by the plaintiff or by

the defendant, for the purposes of my question that is immaterial, but in going into the conduct of the parties, what relationship would you say that the charges that you made for your services had so far as the time and effort you put in in covering the subject of the conduct of the parties is concerned compared with the subject of the claim by Mrs. Gilmore of a substantial community interest in the stock of those three automobile dealerships? [fol. 142] A. I am not sure I understand your question, Mr. Freed. I might say generally that the fight over conduct was more or less incidental, and it started out as what you might try to say would be a good, clean divorce trial, if there is such a thing, with the parties both wanting a divorce. There wasn't any question about the desire of a divorce.

Mrs. Gilmore began referring to some alleged sexual aberration—I am trying to think of the term she used—

MR. MELCHIOR: I know it; "Revolting suggestion".

THE WITNESS: Revolting suggestion, that was it. She kept saying that he preferred revolting suggestions.

Well, the newspapers picked it up. We were in the early stages of the trial at that time. It was a rather shocking thing, and, of course, the newspapers picked it up, and Mr. Gilmore was sort of worried about what the automobile people would think, and about his franchise, and by that time I had called counsel into chambers, and I told the Judge, and I told them, that I didn't think we should go into that. She wouldn't say what the suggestions were, really. I told him if he persisted in it, we would have to throw it open in order to more or less clear Mr. Gilmore in the eyes of the companies he represented.

Mr. Christin wouldn't do a thing about it, so it was thrown wide open, and that was an incident of the trial that was regrettable, but it developed into quite a bit of time.

Q. Did you bear in mind, for example, that the result [fol. 143] of the divorce case could have some effect upon the division of community property in case the Court found there was some community property?

A. Well, yes. Of course, in California if the decree is granted to one party, that party is entitled to more than half of the community property.

Q. In what cases, a case of adultery or extreme cruelty?

A. In the case of adultery and extreme cruelty which was charged here, so there was the possibility that if the Judge believed her in all the things that she said, and she had charged both cruelty and in a Supplemental Complaint she charged adultery, and if the Judge should believe her, and if the Judge should find community property, he could give it all to her.

Q. So that was one of the important issues, was it, so far as you were concerned?

A. Yes.

Q. Mr. Myers, during the entire period of time that you were in the case, did you personally participate or have any knowledge of any offers or overtures, may I call it, toward reconciliation of the parties?

A. Oh, no.

Q. As far as you knew, was the marriage at an end so far as the relationship of the parties is concerned?

A. I know of no consideration that either party gave to reconciliation.

[fol. 144] Q. No efforts were made on your part, then, to save that marriage?

A. No.

Q. Was quite a bit of attention given during the course of the trial to the salaries that Mr. Gilmore got from the three corporations and to whether the salaries did adequately pay him for his community services?

A. Oh, yes. We brought either two or three expert witnesses to testify that he was amply compensated for the nature of his work by the salaries he received.

Q. Mr. Myers, Mr. Pester and Mr. Miner and Mr. Melchior and I were over at your office the other day to see you about the fees that your records indicated you had received from Mr. Gilmore during 1953 and 1954.

A. Yes.

Q. At that time you examined your records and there was a difference, I believe, between the records that we had and the records you had of about $2,231, something like that?

A. You said so.

Q. I will withdraw that question and tackle it a different way.

During the years 1953 and 1954, do you know what the total amount of fees was that you received?

A. Well, it was $14,000—

MR. PESTER: Just a moment. I would like to have him answer that question yes or no, because I think his [fol. 145] books will be the best evidence of what he received.

THE COMMISSIONER: First answer yes or no about that, Mr. Myers. Do you know? Do you remember exactly?

THE WITNESS: I know within a few hundred.

THE COMMISSIONER: All right.

MR. FREED: Q. Do you know?

A. Within a few hundred.

Q. What is your knowledge on the subject?

A. $14,265 or something. Now, I'm not sure about the 265, but it was a little over $14,000.

Q. Good enough.

A. And my records indicate, I think, that.

Q. Would you say that that was reasonable?

A. It was too cheap. It was very reasonable, I think.

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MR. FREED: Q. Mr. Myers, have you given any thought since you were asked to come in here as a witness to what proportion, about what proportion, of the total fees that you charged in 1953 and 1954 would be attributable to your services to defend and conserve the interests [fol. 146] of Don Gilmore and the three corporate dealerships?

A. Well, I have given some thought to it, yes.

• • • •

MR. FREED: Q. Well, what portion or percentage—

THE COMMISSIONER: Of the services you rendered?

MR. FREED: Q. (Continuing)—of your total services you rendered were directed to the preservation and protection of Mr. Gilmore's—

MR. PESTER: I want to make the same objection.

MR. FREED: (Continuing)—interest in the automobile dealerships?

MR. PESTER: The same objection, Your Honor.

[fol: 147] THE COMMISSIONER: I will overrule that objection. He may state his opinion, since he tried the case.

THE WITNESS: Well; I think practically all of it. That is, the bigger share of it, anyway. I felt we were just really fighting for about one thing, and that was to clear that as his separate property. That is for the most part.

There were a lot of incidental things done, but the most of it was for that.

MR. FREED: Q. Mr. Myers, after the final decree was entered, which I believe was October the 25th, 1955, were you called upon to make any determination whether Don Gilmore had any community property accumulated at the time of the final decree?

A. I have a recollection that Jim MacInnis, who handled Mrs. Gilmore's affairs during the appeal, at some time about the conclusion or shortly thereafter, contacted me, and I think he talked to Mr. Haun, and demanded an accounting of community accumulations that might have accrued during the interlocutory period. I think I worked on some sort of an accounting, roughly, and I talked to MacInnis, I am sure, a couple of times, and I talked to Mike Haun about it. I feel quite sure I talked to both of them. I think there was correspondence on it.

You have all my files there.

Q. Yes. I will show you something here from your files that may very well refresh your recollection on that. Here [fol. 148] is a legal document. Counsel appear to be James Martin MacInnis and Nicholas Alaga, a Motion for the Termination of Community Property and further and final allowance of counsel fees. Is that on that subject that you were just referring to?

THE COMMISSIONER: Show it to him.

MR. FREED: Suppose I let you look at your file.

A. Yes, I remember.

MR. PESTER: Could I see that document, please.

MR. FREED: Certainly.

Q. Here is the correspondence between you and Mr. Goebel.

A. Yes, I had correspondence. My file reflects correspondence in this connection with—

Q. Do you know the condition from examining your file of the community at the time of the final decree?

A. There never was any community property, and there wasn't any at that time.

Q. Was the community solvent or insolvent, using that term to describe whether there was a deficit?

A. You would have to say it was insolvent.

Q. Do you have any knowledge to what extent the community was insolvent?

A. Well, I see in the file here a recapitulation which would appear that during the period, or at least a good part of the period, there was a salary income of $93,000, and a disbursement of $214,923.82, which included many items in the payment of community debts and taxes and household expenses.

[fol. 149] Q. Would you read those dates again. What were the dates?

A. Well, I see an accounting re alleged community property for the period July 1st, 1953, which was at about the time of the interlocutory decree, I guess, to October 30, 1955, which was at or about the time of the final decree. It reflects seven items of disbursement which total $214,923.82.

MR. FREED: No further questions.

## CROSS EXAMINATION

MR. PESTER: Q. Mr. Myers, these two dates that you have there, the first one was in June of 1953?

A. July 1st, 1953.

Q. What figures do you have for July 1st, 1953?

A. Well, this was an accounting period.

Q. What was an accounting period?

A. These are totals for a period of time.

Q. What period of time?

A. July 1st, 1953 to October 30, 1955, a period of about two years, a little over two years, during the time of appeal.

Q. During that period of time there was more money expended than salary?

A. Yes. His salaries for that period, according to this accounting, were $93,040.15.

Q. What are some of the items for which those expenditures were made?

A. "Paid to Dixie Gilmore, pursuant to Court order for alimony, $13,789.66.

[fol. 150] "Paid to attorneys for plaintiff and defendant and trial expenses, $48,228.53.

Household expenses, present living expenses, medical expenses for Don Gilmore, $23,255.48.

Interest on loans, $6,120.45.

Federal and State income taxes, $23,342.89.

Payment on community debt owed to Bank of America, $49,000.

Payment on community account to Don Gilmore San Francisco Corporation, $51,186.81.

Total disbursements, $214,923.82."

Q. That is what you mean when you say that there was a deficit?

A. That is what I mean.

• • • •

MR. PESTER: Q. You said that you had Mr. Schwerin determine the amounts of the salaries paid to Mr. Gilmore, to show where the money came from?

A. I had him prepare an exhibit, yes.

Q. What did you ask him in that exhibit?

[fol. 151] A. I asked him to do this: He had most of the material, and I asked him to prepare an exhibit that would show the total salaries received by Mr. Gilmore during the period of marriage and, as you know, it was a large sum of money. Then, I asked him to detail it. I asked him to charge his separate income with the highest rate of income tax, and his community income the lowest rate of income tax. I asked him to set forth all of the household expenses and expenses of the community, such as travel, all community obligations, and he did that. When he got through, the community expenditures far exceeded the community income, and reflected it.

Q. Did Mr. Freitas turn any papers over to you reflecting the same subject matter when he stepped out of the case?

A. Not that I remember.

Q. Do you know whether or not any of these documents that were turned over to you—I forget this witness' name all the time—

A. Were turned over to me?

Q. No, whether or not Mr. Schwerin had any of these documents prior to the time that you asked for the information. You said he had considerable of that.

A. He undoubtedly did. He had prepared statements which reflected the corporate operations under the franchise, and he had sheets of those, but what I wanted him to prepare was one exhibit, and he did not have that prepared, because I dictated the form. He prepared it with the material he had. He prepared that in accord-
[fol. 152] ance with the form I wanted.

He already had all the information, and I had nothing to do with the reflection of the income and disbursements of the corporations. He had that all prepared.

Q. That is the document which determined whether or not the Court would hold with respect to the community property, if it was, or whether she had an interest in it?

A. That document, in my judgment, won the case for us, so far as community property is concerned, and that is what we were fighting for, to keep all of his separate property from being classified as community property.

Q. I believe you said your main objective in this case was to get a favorable determination for Gilmore with respect to the corporate investments?

A. I think that was his objective, and it became mine.

Q. It became yours?

A. Yes.

Q. As I understand it, the issue of a joint tenancy of two properties was in this case?

A. Yes, it was.

Q. That was determined by the Court?

A. Well, there wasn't much to determine. Two deeds were put in, and they—

Q. Well, there was evidence offered and a determination made by the Court?

A. Yes. I think the Court determined they were in
[fol. 153] joint tenancy.

Q. Now, the question of alimony was in the case too, wasn't it?

A. Yes.

Q. Testimony was put in regarding that issue?

A. Yes.

Q. Some of that testimony pertaining to the community property and alimony would probably be interlocking, would you say?

A. Well, yes, the evidence was.

Q. When it came to the determination of the reasonableness of the salaries of Mr. Gilmore, that was also an issue in the case?

A. Well, inasmuch as if he were not completely compensated for his work, the accruals on the corporations would be tainted with community property. To that extent it was, because we didn't want any increase in the corporate franchises to reflect any community interest.

Q. I believe you testified that shortly after this case went to trial there was some testimony before the Court which, as you say, caused Mr. Gilmore to fear the effect on the General Motors?

A. Well, I don't know how much attention he paid to that, but he told me that the company would not permit him to hold franchises if it were established that he was greatly in the wrong in a matter involving that type of a charge.

[fol. 154] Q. What did you do then?

A. Well, I don't remember exactly when that was, but I know early in the trial, when Mrs. Gilmore started mentioning these repulsive suggestions, I tried to get them stricken from the record and I was unsuccessful in that. I thought it was about time we have a conference on it, so I asked for a conference with the Judge and Mr. Christin.

Q. What did you do with respect to putting on evidence regarding that issue?

A. When she went right on to tell her story, and he said I was trying to beat him over the head with a club in court, and she testified at some length under his direct examination with regard to abnormal sexual—

MR. FREED: You are talking about Mr. Christin's direct examination now?

THE WITNESS: Yes. Naturally we brought up a witness that completely refuted it, and we spent a lot of time. She was examined for a long time, and I cross examined her at some length on that, with regard to trips to Paris and a situation that occurred over there, and a situation that occurred some place up in Canada, the Empress Hotel, I think it was, and there was a lot of testimony in the record about that. Then, we brought the witness that completely refuted her, and the Judge just didn't believe her.

MR. PESTER: Q. Are you familiar with the Transcript of Testimony in this case?

[fol. 155] A. Well, I haven't been over it for a long time, and I don't want to go over it, either.

Q. I was going to ask you whether it isn't a fact that the last four volumes are devoted practically exclusively to conduct?

A. I haven't made that appraisal, but it is possible. There was a lot of very, very nasty testimony that made me ill.

Q. Of course, the record would reflect better than you could state with respect to the amount of evidence that was offered on these different issues, would it not?

A. Yes, of course the record is clear. My memory is five years old.

Q. You at no time made any effort to make an allocation of your services to any of these issues that were involved in this case?

A. Well, not—I didn't finalize any. Mr. Gilmore asked me some time after the conclusion of the trial about that, and I told him I would give some thought to it; that I thought perhaps most of it was, but I didn't know that I could specifically state any certain percentages. I think he dropped the matter then, and I don't know that he ever pressed me for an exact percentage.

Q. You wouldn't state an exact percentage now, would you?

A. Not an exact percentage, unless I said all of it. I think his ultimate goal was for the whole thing. We never, in the trial of the action—we hadn't hoped that [fol. 156] we could beat alimony. I don't know that

alimony was ever a real consideration of ours. We figured she would get alimony. We figured that we were not fighting about alimony, because we figured she would get it for a period of time. About that time, the Courts were, for short marriages, specifying time. It had been the practice in Marin County before that, during our Judge Edward I. Butler days, to just leave it open for an undetermined period, but at about that time the new Judges were—

MR. PESTER: If the Court please, I am going to object. I don't think this is responsive to my question.

MR. FREED: I think it is. I think it is quite responsive.

THE COMMISSIONER: I think he is trying to answer it, Mr. Pester. Go ahead, and you can ask him another after he concludes.

You are talking about the alimony now, and it was not a big factor so you didn't actually make any mathematical allocations at that time, did you?

THE WITNESS: No, I did not.

THE COMMISSIONER: All right, Mr. Pester, I think that answers it.

MR. FREED: What about the testimony he was just giving there?

MR. MELCHOIR: He was interrupted there.

MR. FREED: Yes, interrupted very effectively, I think.

[fol. 157] THE WITNESS: I would only conclude, if I may do that, that at about that time they were saying, in cases of short marriages, which this was classified as a short marriage, that there would be alimony for two years or three years, and, frankly, we had not considered that alimony for a reasonable period of time would be objectionable, or that we could avoid it.

MR. PESTER: Q. You were engaged in the trial of this case for about 21 days?

A. 24 trial days.

Q. 24 trial days?

A. It wound up at 7:00 o'clock at night, when I was due in Sonoma County the—

Q. Let's assume that the community property issue were not involved in this case. What would you consider a reasonable attorney's fee for handling the divorce action?

MR. FREED: I object on the ground that it is incompetent, as well as irrelevant and immaterial.

THE COMMISSIONER: Wouldn't that be speculative, since that assumes a fact not in issue, Mr. Pester? I mean, it is not in evidence.

MR. PESTER: I think all of the facts are in evidence. I am just asking that he exclude one element of this case.

THE COMMISSIONER: If you want him to exclude one element and state how much of his services were attributable to the other elements, he may answer as to [fol. 158] that. Rephrase your question.

MR. PESTER: Q. Let's eliminate from this Gilmore divorce action the community property issue. Upon the trial of the case, on all the other issues involved, what would you consider a reasonable attorney's fee?

A. Well, in the first place, the case wouldn't have lasted two days, and I would have probably charged him about $1,000.

Q. You mean it wouldn't last two days with all this conduct issue in it?

A. We would have never gone into it. She could have walked into Court and had a divorce and gotten alimony for a reasonable time, and there would never have been a fight. We were not fighting about alimony.

Q. Well, you were fighting the divorce, and the conduct of Mr. Gilmore—

A. We only had to fight it because she was asking for something like $300,000 in money that didn't belong to her, and she was trying to taint that with community property.

Q. Isn't it a fact that you also fought on the conduct issue?

A. Certainly we fought on the conduct issue.

Q. Wouldn't that have taken more than a day or two days?

A. Well, may I put it this way, Mr. Pester: If you are fighting over $1,000, you don't try a 24-day case—

I don't. That case wouldn't have lasted two days, because we would have never really pressed it.

Q. But the $1,000 wasn't involved in the conduct issue, [fol. 159] was it?

A. The conduct issue was only involved because there was $600,000 or thereabouts of property involved. That is the only reason.

Q. Isn't it a fact that the conduct issue was raised by her, and that was the thing that took you into Court for a conference with the other attorneys?

A. Well, that was when she was trying to get the lion's share of property that she claimed was community property, which was not, in fact, community property. We couldn't avoid the double-barreled fight. We couldn't say, "Well, you take a divorce and then we will go on and see whether it is community property," because if she had gotten the divorce without a contest, and then the Judge had said, "Well, I really think there is about $500,000 worth of community property," then we would really have been in a bad predicament.

Q. But that community property was based upon the ownership with respect to Gilmore? That is, with respect to Gilmore's ownership prior to the marriage, of Gilmore to Dixie?

A. Well, he owned the stock, and it was a sort of a one-man corporation thing, and he was the main party involved. It was one of those cases where the Court can very easily look through the corporate setup and see the individual, and we were afraid he might, unless we established the facts as we did.

Q. With respect to the other evening, when Mr. Freed, [fol. 160] Mr. Melchior, Mr. Miner and I were out to see you, you computed the amounts paid to you and they totalled $13,033.83; is that correct?

A. No, I wouldn't say that is correct. I didn't look over my records myself. I had a new girl run off a tape, and I don't know what it showed. As a matter of fact, you may have it. I gave it to somebody.

MR. FREED: I have it. I mean, I took it.

THE WITNESS: I don't know what the totals were, but I am sure that I received for the services something over $14,000 in two years.

MR. PESTER: Q. How would you account for the difference between the $13,033.83 and the $14,000 and some odd dollars?

A. I wouldn't try to account for it. I received the money and I don't know—I am not trying to account for it. I know what I got.

Q. But the computation which the girl furnished you didn't equal that amount.

A. I wouldn't say that. I don't know what it showed. I turned them over to somebody, and I don't have them. I don't remember totalling them. I think they did. As a matter of fact, I think—

Q. Didn't you run them off on an adding machine?

A. Yes, I did. I think they totalled $17,000, as a matter of fact.

Q. You showed them to Mr. Miner, and Mr. Miner [fol. 161] made a note of them?

A. I certainly did. The three years totalled $17,000. Now, how it was broken down by year, that I can't tell you, and if Mr. Miner can, he might refresh my memory.

MR. FREED: Here, I have it. Eureka!

MR. PESTER: Hand it to the witness.

THE COMMISSIONER: Yes, let him see that.

THE WITNESS: Well, this isn't my writing on here, but I suppose this is the tape that came off, and for the two years it indicates $14,033.83. I think that is short by a couple hundred, something like that.

MR. PESTER: Excuse us just a minute, Judge.

THE COMMISSIONER: Yes.

MR. PESTER: I want to offer that in evidence, if the Court please.

THE COMMISSIONER: Does the record show clearly that Mr.—

MR. FREED: Wait a minute—oh, excuse me. I am sorry to interrupt you. I wanted to mention the fact that I wrote that. That is my handwriting up there.

THE COMMISSIONER: That is what I was going to ask about, that Mr. Myers did not put the handwriting on the exhibit, but he did prepare or have prepared the adding machine type figures shown thereon? Is that correct, Mr. Myers?

THE WITNESS: I will tell you what happened. My secretary, who has been with me a very short time—well, [fol. 162] we went up in the loft and got out the old books, and she presented to me a statement on a yellow sheet. I don't know whether I gave that to Mr. Freed or not.

MR. FREED: No, we left it there.

THE WITNESS: I totalled up the year 1953. I ran off the tape on what she had, and I got $12,033.83 for the year 1953, and I ran a total on the year 1954 and got just $2,000, or a total of $14,033.83.

Now, my memory tells me that is not the correct amount. I'm quite sure there is a couple hundred somewhere. It is just a small amount.

THE COMMISSIONER: At least, on the basis of the records that you then found, this was the correct total?

THE WITNESS: That was the total I had then.

THE COMMISSIONER: It may be admitted in evidence as Defendant's—I understand you have no objection, Mr. Freed?

MR. FREED: No.

THE COMMISSIONER: Defendant's Exhibit No. 1. You may so mark it, Mr. Reporter.

(An adding machine tape containing figures and hand written information was marked as Defendant's *Exhibit A*)

MR. PESTER: Q. Is this the total amount that you received from Don Gilmore during those two years?

A. The first two years, I think there is two or three hundred missing. Now, I don't know where it is. I didn't go over my books again. I think I received about—there [fol. 163] must have been a bill some place. Did you find a bill of mine?

MR. FREED: There is a document here. I might as well produce this, because it has been bothering me.

MR. PESTER: Just let me examine this witness, first.

THE COMMISSIONER: Wait, Mr. Freed, until we finish the cross, and you can cover that. Go ahead, Mr. Pester.

MR. PESTER: Q. I want to know whether that reflects all of the fees that you were paid by Don Gilmore

during those years as shown there, other than a couple hundred that you think might be missing.

A. Yes, I think so.

Q. Did you do any other business for Don Gilmore in the year 1953?

A. I don't remember any.

Q. Did you do any in 1954?

A. Except for this case, it would have been very incidental. I don't know.

Q. The evening that we were there, didn't you pull out a file that pertained to some other case?

A. Yes. In '56 we had a—I think in 1956 we brought an action for rent and ejectment.

Q. Have you got that file with you?

A. No—well, wait a minute. Maybe I gave it to—yes, I gave all my files to Mr. Freed. It was in 1955. Judgment for restitution of the property was the pleading in 1955.

Q. When was the action commenced?

[fol. 164] A. October 13, 1954.

Q. And it was concluded?

A. March the 2nd, 1955. As I recall, there is a charge that came on later. I don't know. I told you I couldn't identify it positively, but for 418 or thereabouts. Now, I wouldn't say that is exactly it, or that was the case, but—

Q. Yes, you got a fee in 1956, and you thought that that was for this case?

A. No. We had I earned a lot more than that. We had the appeal, you know. When the case went up on appeal, I billed Mr. Gilmore along, and I think he paid me, over the next couple of years, '54 55, in there sometime, another two or three thousand dollars for the appeal work. The first fee of $14,000 plus was for the trial only, and for all the work I put in after that he paid me, of course, extra. I billed him for it.

Q. Do you know how much you charged him for this?

A. I can't state without looking at my other records.

Q. You don't know whether he paid you anything in 1955 for the services rendered in connection with that case?

A. In 1955? Oh, he might have in '55. I suppose he did. I think probably he did in '55. I don't think he paid me anything in '54 on it.

Q. That is when the action was commenced?

A. Yes. I don't think he even advanced the fees. When I have a good client, I usually advance small fees. [fol. 165] small filing fees, for the Superior Court. He might have sent the costs over. I don't know.

Q. Are you in a position to say that none of these items that were received during the year 1954 included a payment with respect to services rendered in connection with that case?

A. I am quite positive that the record of '53 payments and the record of '54 payments does not in any way cover this action which was started in the fall of '54.

Q. And concluded when?

A. In March of '55. As I recall, we had more or less of a settlement. I was leaving for Europe in the spring of '53, and right after the trial, it was a very short time, I left. I was gone for a month or so, and I think my best recollection is that the fee of $14,000 plus a few hundred was for the trial of that case, and that the other amounts which he subsequently paid me were for the appeal work and for things like that. I think I have one payment of 418 or thereabouts which I had more or less thought that might be this case.

Q. That was paid to you in 1956?

A. Well, '55 or '56. I don't know. I would have to check my records. I am quite sure it wasn't paid in '54.

Q. In a case that was started in '54 and ended in March of 1955, you got no fee whatever until the year 1956, according to your—

A. I didn't say that.

Q. What did you say?

[fol. 166] A. I said I was probably paid in 1955. Now, may I see that sheet again, the one that was offered in evidence. The adding machine record. This adding machine record shows that, as I read it, during the year '55 I was paid, over and above $14,000, the sum of $3,478.05.

A lot of that was for appeal work, and it is possible some of it was for this case. After this, I think there

was still another $418 paid to me in either '55 or '56. I think the most of this 1955 payment of $3,478.05 was for appeal work in the divorce action.

Q. The work done with regard to the appeal would be reflected in conjunction with what is set out in the Briefs?

A. Yes, we were still—

MR. PESTER: I think that has been answered.

THE COMMISSIONER: That is right.

THE WITNESS: It has.

MR. PESTER: Q. Mr. Myers, can you tell us whether you ordered the printing of the Transcript in connection with the appeal?

A. You mean in the Superior Court?

Q. Yes, the Transcript was typed by the Reporter?

A. Yes.

Q. Did you ask that that Transcript be typed so that you would have the record on appeal?

Q. Well, I can only tell you what usually happens. Usually the Appellant files a Notice of Appeal and a [fol. 167] request for the preparation of the record, and I suppose that was done in this case. Somebody has to have it. The Supreme Court wouldn't—

Q. Yes, and that would be at the Appellant's request?

A. Well, ordinarily they file—under the rules, the Appellant must file his Notice of Appeal, and within 10 days file a notice to prepare the Reporter's Transcript on the evidence, and if there is anything missing, then the Respondent sets forth the things that should be in the record too.

Q. You didn't ask for the Transcript to be typed up. You weren't appealing?

A. We didn't file the appeal.

Q. No.

A. We didn't file the appeal.

Q. If Mr. Gilmore paid for that Transcript, that was paid for the benefit of Dixie, in connection with her appeal; is that right?

A. I don't think so.

Q. For whom would it have been, then?

A. Well, in every case that goes up, ultimately the loser pays for—ordinarily pays for the Transcript. We

had to fight it or take the chance of paying for it. I suppose we paid for it, yes. Gilmore paid for it, because he was ordered by the Court to pay for it. I remember now, if you are talking about who paid for it.

Q. I am talking about who paid for it and who ordered it.

[fol. 168] A. Well, I would assume that the Appellant ordered it, and I am quite sure Mr. Gilmore paid for it at the order of the Court.

MR. PESTER: I believe that is all.

MR. FREED: No questions.

THE COMMISSIONER: You may be excused, Mr. Myers.

(An adjournment was had until 10:00 o'clock in the morning of October 27, 1959, to be resumed at Room 59 of the Federal Office Building in San Francisco, California)

[fols. 169-218] • • • • •

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[fol. 219] TUESDAY, OCTOBER 27, 1959

THE COMMISSIONER: All right, Mr. Pester, we will take your witnesses now.

(Testimony for defendant)

MR. PESTER: We will call Mr. MacInnis.

[fol. 220] JAMES MARTIN MacINNIS, a witness produced on behalf of the defendant, having first been duly sworn by said Commissioner, was examined, and in answer to interrogatories testified as follows:

THE COMMISSIONER: Give us your name for the record.

THE WITNESS: My name is James Martin MacInnis. I am a lawyer. I live at 2511 Baker Street, San Francisco. My office is 41 Grant Avenue, San Francisco.

THE COMMISSIONER: All right, Mr. Pester, you may examine.

MR. FESTER: Q. Mr. MacInnis, you are admitted to practice in all courts of the State of California?

A. Yes.

Q. Were you engaged as an attorney in the Gilmore versus Gilmore divorce proceedings?

A. Yes.

Q. When did you first become interested or become attorney in connection with that case?

A. Sometime in the spring of 1954, after the decision before the trial court, and pending the taking of an appeal.

Q. So you came in after the trial of the case had been concluded?

A. Yes.

Q. Do you know or can you recall the issues that were involved in that litigation?

[fol. 221] A. Yes.

Q. Will you name them, please.

MR. FREED: Just a moment. I object to that, Your Honor. We have the pleadings in evidence, and we have the Transcript.

THE COMMISSIONER: Yes, but I permitted plaintiffs' witnesses to testify generally about the issues, and while the pleadings will govern, the objection is overruled. The witness may give his recollection.

THE WITNESS: The trial judge basically had denied any relief to Mrs. Dixie Gilmore. He had granted the divorce to Don Gilmore. He had declined to recognize the theory of double divorce, which at that time was a novel doctrine in California. He had declined to recognize that any of Gilmore's properties were community property, and he had declined to recognize that admitted acts of misconduct on the part of Gilmore should be viewed in the same light as the evidence concerning the bad conduct of the plaintiff, which he had believed.

Those were basically the issues. There were sub issues which flowed from them, whether or not the element of condonation existed in the case; whether or not there was an intermingling of properties to the extent that the nature of the property had become lost. There was a

further issue as to whether oral declarations and conduct between the parties had affected the nature of the property. There was a further issue as to whether the [fol. 222] character of the prevailing party, Don Gilmore, as revealed by the evidence, was such that he was incapable of having the notion of extreme cruelty inflicted upon him. Those are some of the minor issues which flowed from the major ones.

Q. In the appeal of the case, what was your primary objective?

MR. FREED: Just a moment. I object to that on the ground that this tax case does not concern the objectives of the plaintiff, Dixie Gilmore, represented by Mr. MacInnis, who, by the way, is only the attorney on appeal, not the attorney in the trial court.

MR. PESTER: Well, I asked him—I limited my question to the appeal matter.

MR. FREED: It concerns only the objectives of Don Gilmore, and the services performed by his attorneys to accomplish those objectives.

THE COMMISSIONER: I think as a matter of law you can argue that, Mr. Freed. As a matter of the admissibility of evidence, I will overrule the objection.

THE WITNESS: The objective was to obtain a reversal of the case. Of course, there were facets of that objective too.

MR. PESTER: Q. Who ordered the Transcript of the trial in the lower court that was necessary for the appeal?

A. If I correctly recall, the lawyers for Dixie Gilmore, at that time in the person of myself, I am fairly certain, [fol. 223] made an application before Judge Martinelli, who had tried the case, asking that costs on appeal be awarded the appellant, and the major cost would have been the Transcript of Evidence. The other factor of cost would have been the printing of Briefs. The Judge granted the request in both instances.

Q. After you came into the case, Mr. MacInnis, did you have any negotiations pertaining to the proposed settlement of the litigation?

A. Some. There was no great finality to any of them. I attempted, as I suppose would be true of any lawyer

in the same situation, to salvage something out of a case which had already been lost. I suppose I made overtures to Mr. Wallace Myers and to Mr. Michael Haun, who represented Don Gilmore.

The initial overtures that I made were not well received, because they pointed out that they were somewhat belated; that they should have been made earlier; and they didn't feel that their position was such that they could advise their client to pay very much money. There was some small measure of concession that was offered at that point, but in around May of the following year, 1955, we were fortunate enough to obtain a reversal of the case in the District Court of Appeal, the First Appellate District, Division One, in an opinion written by Mr. Justice Bray.

At that time it would have appeared that Dixie Gilmore was restored to her original position, and then there were some serious negotiations. Then, the attorney for Dixie [fol. 224] Gilmore became over-confident and didn't accept the settlement offer at that point, and then the other side won in the Supreme Court, which granted a hearing.

Q. With whom did you negotiate in 1955? Did you say?

A. Yes.

Q. After the reversal?

A. Yes, with the same lawyers, Wallace Myers and Michael Haun.

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[fol. 225] MR. PESTER: Q. Mr. MacInnis, do you have knowledge of the efforts that were put forth by the defendant's counsel?

A. I can say they opposed what we did vigorously, on every issue. Do you mean by way of things done outside those matters which would be revealed by Briefs or by arguments in Court?

Q. No, I mean now on appeal with respect to matters that pertained to the appeal.

A. Well, concerning their efforts, I wrote a lengthy Brief which you were kind enough to show me before I took the witness chair this afternoon, and in looking over the sub-index I see that these matters we have discussed

[fol. 226] were all covered in great detail. I remember that, of course, each proposition that was voiced by us was answered by the other side in its Brief.

Q. That is the extent of your knowledge pertaining to the efforts—

A. Well, I know they worked on phases of the case that would not necessarily be capsuled into Briefs, but I would know that only from my contacts with them.

Q. That was your contacts with them in connection with the divorce action?

A. Yes.

Q. Can you give us an opinion with reference to the percentage of efforts put forth by the defendant's counsel?

MR. FREED: I object again. I don't think a proper foundation has been laid. This witness has referred to the Briefs and said the points raised by him were answered, and vigorously.

THE COMMISSIONER: Yes. He also said, though, he had some information by personal contacts.

MR. FREED: Personal contacts? What contact was that? Did he observe how they worked, how much time they put in on one issue?

THE COMMISSIONER: You might inquire about that, Mr. Pester.

MR. PESTER: Q. Did you observe the time that these people put in on these issues?

[fol. 227] A. No, because actually these issues all overlap in California law. If a person gets a divorce upon the ground of cruelty, the Court is not authorized but directed to award to that party more than 50% of any community property, so that the factual issues of conduct and the issue of community property merge to that extent.

Then, the credibility of parties will be an issue which will merge where there are different assertions by them about the manner of treatment of property. I couldn't offer any assistance on percentage of effort for either side in the case.

Q. Do you think it is possible in an action such as this to determine a percentage of effort on any particular issue?

MR. FREED: Just a moment. I object to this on the ground it has been asked and answered and fully covered by the question previously asked and the answer.

THE COMMISSIONER: I think it is a little different in form. Overruled. He may answer.

THE WITNESS: I am sorry, would you repeat that.

(Reporter read the last question)

THE WITNESS: No.

MR. PESTER: That is all.

MR. FREED: No questions.

THE COMMISSIONER: Mr. MacInnis, you are excused, sir.

We will take a five minute recess.

(Short recess)

[fol. 228] THE COMMISSIONER: You may call your next witness.

MR. PESTER: We will call Mr. Christin.

CHARLES A. CHRISTIN, a witness produced on behalf of the defendant, having first been duly sworn by said Commissioner, was examined, and in answer to interrogatories testified as follows:

THE COMMISSIONER: Mr. Christin, give us your name for the record.

THE WITNESS: Charles A. Christin.

THE COMMISSIONER: Where do you live at the present time?

THE WITNESS: 2660 Green Street, San Francisco.

THE COMMISSIONER: All right, Mr. Pester.

## DIRECT EXAMINATION

MR. PESTER: Q. Mr. Christin, you are admitted to practice in all courts of the State of California, are you?

A. Yes, sir.

Q. Were you one of the attorneys in the divorce action of Gilmore versus Gilmore that was had in Marin County in about 1953?

A. I was.

Q. Whom did you represent?

A. Mrs. Gilmore, Dixie.

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[fol. 229] Q. Did you prepare the Complaint in the case?

A. I did.

Q. Are you familiar with the issues that were involved?

A. I am.

Q. Can you name some of those issues, or the issues—

MR. FREED: I am going to object to that.

THE COMMISSIONER: The objection is overruled. As I earlier indicated, of course, the record on that will control, but inasmuch as the witness was one of the counsel in the case, I will permit him to give his recollection for this purpose.

THE WITNESS: General cruelty, first, general demurrer, insufficiency of facts, amended to include adultery.

MR. PESTER: Q. Was there an issue pertaining to joint tenancy of some property?

A. Not in the pleadings.

Q. Not in the pleadings? Did that arise in the case?

A. It did.

Q. Did any other issues arise in the case that you didn't set out in your pleadings?

A. Well, the adulterous conduct had to be proven. It was generically stated as adultery, then it has to be proven specifically.

Q. Was alimony involved?

A. Oh, yes, property settlement.

Q. That is community property?

[fol. 230] A. Well, there was the issue. They were married six years.

Q. And salaries?

A. Oh, yes, ability to pay alimony if allowed.

Q. In your opinion, which was the chief issue in the case, if there was one?

MR. FREED: Just a minute. I object to that, if the Court please, on the ground that what Mr. Christin regards as the chief issue is immaterial and irrelevant, because we are concerned here only with the relationship of legal expenses to services rendered by counsel for the defendant, not for services rendered by Mr. Christin.

THE COMMISSIONER: Yes, but the objection is overruled.

THE WITNESS: May I have the question.

(Question read by the Reporter)

A. Getting a divorce, generically speaking, but specifically, first of all, getting the award of a divorce, to be followed by some sort of adjudication by the Court of the property rights and alimony, permanent or temporary.

I mean by temporary, for a limited period of time, because of the brevity of the marriage.

THE COMMISSIONER: Because of the brevity of the marriage?

THE WITNESS: Yes, because, in other words, you don't get very much for six years. You don't get that answer, "The Best Years of My Life." You don't get that one. If you don't get that answer, you don't get much.

MR. PESTER: Q. In connection with the trial of this [fol. 231] case, and prior thereto, did you have any negotiations for settlement?

A. I did.

Q. With whom were those negotiations?

A. Haun, Gillen and me.

Q. That was prior to the trial?

A. I believe so, or during the trial. I can't remember.

Q. Mr. Myers was not in on any of those?

A. Not to my recollection.

* * * *

MR. PESTER: Q. In connection with the trial of this case, did you have occasion to observe the efforts that were put forth by defendant's counsel on these respective issues?

A. Well, I saw the manifestation of his activities in Court, by their conduct, and in preparation, and saw what they did, by that, by their efforts. I would say that I observed their physical and mental and legal acts.

Q. Could you then give an opinion with reference to the percentage of efforts which they put forth on these respective issues?

MR. FREED: I object again, if the Court please, on [fol. 232] the ground that an adequate foundation has

not been laid yet. There has been no showing that Mr. Christin knows how much work and what kind of work, the quality and character of the work, that was done by the attorneys for the defendant outside of Court.

THE COMMISSIONER: Of course that is a factor, but I believe that is directed more to the weight of this testimony than its admissibility. I will overrule the objection.

THE WITNESS: Question?

(Reporter read the last question)

MR. PESTER: Q. You may answer now.

A. Well, first, Freitas was in it, Freitas and Haun, and took depositions. Whether you could have adultery after the filing of a Complaint was the issue there. The Judge held it was immaterial, but it showed quite possibly an adulterous disposition. That was deposition. We took all the depositions for the purpose of proving our case. My side, of course, wanted to prevail on adultery. I had five witnesses in the courtroom who he admitted on the stand that he had committed adultery with eight of them in the last twelve weeks, so he was a pretty good man.

Then, we went into the main question then as to whether this most objectionable, filthy and nasty act took place with three people in the room at the same time—

MR. FREED: If Your Honor please, I dislike to interrupt the witness but I don't believe his answer is responsive.

[fol. 233] THE WITNESS: Is it? I am putting the efforts—

THE COMMISSIONER: Mr. Christin, what the counsel has asked you is if you could give an opinion as to the relative proportion of time spent, time or services spent, on these different issues, without describing what they were.

MR. FREED: His efforts.

THE WITNESS: How can I give you the element of time if you don't let me submit the issues? You ask a question specifically, and I will answer it, Mr. Commissioner.

THE COMMISSIONER: Revise your question so he will understand.

MR. PESTER: Q. Could you state the percentage of effort that counsel for the defendant put forth with respect to the respective issues involved in the litigation?

MR. FREED: Just a moment. I object to that question on the ground there has been some foundation relating to trial, but there has been no foundation relating to out of court or on appeal.

THE COMMISSIONER: Of course we are limiting this answer to the trial.

MR. PESTER: Yes.

MR. FREED: Just to the trial, then, in the courtroom?

THE COMMISSIONER: Yes. As to the other part of the objection, it is overruled. First, can you give us an opinion on that, Mr. Christin? That is the first—

THE WITNESS: Give me the question.

[fol. 234] (Reporter read the last question)

A. Well, you want me to pick out the various parts of the litigation? I would say about—well, if you want to talk about proving the case and defending the case, I would say about 80% - 20, 25%. Of course, these are only guesses. I can't pull that out of my mind. It means nothing to me. You are asking me a question I can't—

MR. PESTER: Q. You are now rendering an opinion?

A. I know. Well, the opinion has no foundation because I don't remember. How can I say a proportion of time to an issue at this time? I don't want you to think I am evasive. I don't care who wins this thing.

THE COMMISSIONER: All right, Mr. Christin. We first ask you if you are able. You say you are not able to do that?

THE WITNESS: That question I am not able to answer at this time.

MR. PESTER: Q. Could you state whether the divorce issue and the efforts to prove the case were the chief issues, or was it a subordinate issue in the case?

A. Chief.

MR. FREED: I object to that on the ground that the record is the best evidence, and that Mr. Christin's

opinion of what the most important issue in the case was may be entirely different from the opinion of counsel for the defendants. They were paid for their opinion: Mr. Christin was paid for his opinion.

[fol. 235] THE COMMISSIONER: Objection overruled.

THE WITNESS: Question?

(Reporter read the last question)

A. Well, it was a primary issue. You had to win the first one first in order to get anything out of the second. In other words, I'd say the primary was the most important fact, actually, to get a divorce. Then, after that you try to prove your alimony or property settlement, or property rights

MR. PESTER: I believe that is all, Your Honor.

MR. FREED: No questions.

THE COMMISSIONER: You are excused, Mr. Christin. We will take a short recess.

(Short recess)

OFFER IN EVIDENCE

MR. PESTER: If the Court please, the defendant would like to offer in evidence the Reporter's Transcript of the trial of Dixie Gilmore versus Don Gilmore in the Supreme Court of the State of California—

MR. FREED: I beg your pardon, the Superior Court.

MR. PESTER: Yes, the Superior Court of the State of California for Marin County, together with the Clerk's Transcript.

I think the Clerk's Transcript contains awards of alimony which aren't shown in any of the Orders in the Transcript proper. Am I right?

MR. MELCHIOR: Off the record.

(Discussion off the record)

[fol. 236] THE COMMISSIONER: Mr. Pester, are you ready to have this read into the record?

MR. PESTER: Yes, Your Honor.

THE COMMISSIONER: Proceed, Mr. Melchior, if you will.

MR. MELCHIOR: Page 26 of the Clerk's Transcript.
MR. MINER: Page 11, I believe, is the first place.
MR. MELCHIOR: Page 11 of the Clerk's Transcript:

"In the Superior Court, June 6, 1952.
Present: Honorable Thomas F. Keating, Judge.
George H. Gnoss, Clerk.

Clerk's Minutes:

This matter coming on upon an order to show cause, demurrer. Mr. Christin appearing on behalf of the plaintiff. Mr. Haun and Walter F. Freitas appearing on behalf of the defendant. Sworn, Don Gilmore, sworn Dixie Gilmore, recalled, Don Gilmore.

It was by the Court ordered that the defendant pay the plaintiff the sum of $1250 per month, pendente lite, $1500 counsel fees on account. Demurrer overruled—ten days to answer."

Page 26:

"In the Superior Court, August 22, 1952.
Present: Honorable Thomas F. Keating, Judge.
George H. Gnoss, Clerk.

Clerk's Minutes:

This matter coming on upon an order to show cause, [fol. 237] counsel for all parties appearing. It was by the Court ordered motion to file Supplemental Complaint granted, ordered that the order to show cause re contempt for failure to answer questions discharged.

Sworn Dixie Gilmore, by the Court ordered that $1500 be allowed for investigation fee, $750.00 on account of deposition fees."

Next page?

MR. PESTER: 79.

MR. MELCHIOR:

"In the Superior Court, April 24, 1953.
Present: Honorable Jordan L. Martinelli, Judge
Joseph Henneberry, Clerk: Harvey Prather, Reporter

Clerk's Minutes:

This matter coming on regular continuance, both counsel present in Court at which time recalled for plaintiff rebuttal: Dixie Gilmore. At 11:03 A.M. Court recessed to 11:23 A.M. at which time both counsel present. Recalled Dixie Gilmore, recalled Charles Christin, at 12:00 noon Court recessed to 1:40 P.M. at which time both counsel present. Recalled Dixie Gilmore. Plaintiff rests. Mr. Myers moved the Court to strike all certain evidence. Denied. Mr. Christin proceeded to give oral argument followed by Mr. Myers. At 3:05 P.M. Court recessed to 3:25 P.M. at which time both counsel present. Mr.
[fol. 238] Myers continued his argument followed by Mr. Christin in rebuttal.

It was by the Court ordered decree of divorce granted defendant and cross-complainant, no community property for disposition, Fairfax residence held in joint tenancy, Belvedere residence not joint tenancy, and is separate property of defendant and cross-complainant. $10,000 fee plaintiff's counsel. $750 per month alimony for five years, death or remarriage to be reconsidered at expiration of five years at request either party. It shall not be necessary for moving party to make any other statement other than the above order."

Page 83:

"In the Superior Court, June 29, 1953.
Present: Honorable Jordan L. Martinelli, Judge.
George H. Gross, Clerk: Norman Pauker, Reporter

Clerk's Minutes:

This matter coming on for settlement of findings, Charles Christin and Leslie Gillen appearing on be-

half of the plaintiff, Wallace Myers and Mr. Haun representing the defendant.

A recess was taken at 11:10 A.M. until 11:35 A.M. at which time counsel answered ready.

Court was recessed at 12:15 P.M. both counsel to prepare written findings and return again for the [fol. 239] Court's signature at 4:00 P.M.

Counsel appearing at 4:45 P.M. and again conferring with the Court for settlement of findings.

It was by the Court ordered that an Interlocutory Decree of Divorce be granted to the defendant and cross-complainant, property disposed of in accordance with provisions set forth in Interlocutory Decree signed this date."

Page 109:

"In the Superior Court, August 28, 1953.
Present: Honorable Jordan L. Martinelli, Judge
George H. Gnoss, Clerk; Harvey Prather, Reporter.

Clerk's Minutes:

This matter coming on regular continuance, upon a motion to have costs retaxed by the Court, motion to strike. James M. MacInnis appearing as counsel for the plaintiff, Wallace S. Myers and Michael Haun appearing on behalf of the defendant. Sworn James M. MacInnis, Dixie Gilmore. At 4:55 P.M. Court recessed to 5:10 P.M. All counsel present. Recalled Dixie Gilmore. Sworn for the defendant Henry J. McCullough, Don Gilmore.

It was by the Court ordered motion to strike granted to items, Lipsett stricken, Dr. Lyons to $150; Prather remained. Lindsey mileage allowed, actual cost of Transcript on Appeal payable direct to Re- [fol. 240] porter on filing, respondent pay costs of Briefs, allowance $1,000. Counsel fees on account for appeal, $500 per month alimony pending appeal."

MR. PESTER: Is there an order with respect to the Transcript?

MR. MELCHIOR: That is all, Mr. Pester.

MR. MINER: There are orders that the Clerks prepare the Transcripts, and Reporter to prepare Transcripts, just following that.

MR. MELCHIOR: I have read it into the record. It says:

> "It was by the Court ordered motion to strike granted to items, Lipsett stricken, Dr. Lyons to $150. Prather remain, Lindsey mileage allowed, actual cost of Transcript on Appeal payable direct to Reporter on filing, respondent pay costs of Briefs, allowance —"

et cetera, et cetera.

THE COMMISSIONER: Off the record.

(Discussion off the record)

MR. PESTER: I think that covers it, Your Honor. There is another order here, but—

THE COMMISSIONER: I believe the record should show that the orders that have been read into the record are from the Clerk's Transcript on Appeal from the Judgment of the Superior Court of the State of California in the case of Dixie Gilmore vs. Don Gilmore.

[fol. 241] MR. FREED: I was just going to suggest that I think it would be helpful if those orders were stated to the Minute Orders of the Clerk. They are necessarily just things written in the minutes by the Clerk.

THE COMMISSIONER: Let the record show that those are the Minute Orders of the Clerk; the brief form indicates that.

All right, Mr. Pester, we are ready for your offer of this Transcript of the Testimony in the case.

MR. PESTER: Yes. I offer the Reporter's Transcript, Volumes 1 through 11 and the Master Index.

THE COMMISSIONER: No objection, counsel?

MR. FREED: No objection.

THE COMMISSIONER: The Transcript is admitted and we will give it the number P. with a subdivision 1

to correspond with volume 1 and so on, and the Master Index will be the last number, which will be 12, I suppose.

I will add the request with the admission of this particular exhibit, counsel, that you point out specifically by page and even by paragraph any portions thereof upon which either one of you may be relying, on account of its great length.

(A Transcript of the Testimony and Proceedings in the case of Dixie Gilmore vs. Don Gilmore was admitted Defendant's *Exhibit P*, consisting of 11 volumes and a Master Index, numbered P-1 through P-11, the Master Index being P-12 in evidence)

MR. PESTER: I will call Mr. Miner.

[fols. 242-272] • • • •

[fol. 273] IN THE
UNITED STATES COURT OF CLAIMS

No. 374-58

DON GILMORE AND SUE GILMORE

v.

THE UNITED STATES

*Eli Freed* for plaintiffs.

*Benjamin H. Pester*, with whom was *Assistant Attorney General Louis F. Oberdorfer*, for defendant. *James P. Garland* and *Lyle M. Turner* on the brief.

OPINION—Decided June 7, 1961

LARAMORE, *Judge*, delivered the opinion of the court:

This is a suit to recover the alleged overpayments of income tax, plus interest accrued, for the taxable years 1953, 1954, and 1955. The defendant counterclaims for the years 1953 and 1954.

Plaintiff[1] is the owner of 100 percent of the shares issued and outstanding of a corporation named Don Gilmore—San Francisco. He is also the owner of 60 percent of the issued and outstanding stock of a second corporation, Don Gilmore—Riverside. In addition, he is the owner of 73⅓ percent of the stock issued and outstanding of a third corporation, Don Gilmore—Hayward. Each of the three named corporations is a franchised dealer of a division of General Motors Corporation. Each of these businesses operated under an annually renewable franchise contract which contained a clause giving the [fol. 274] manufacturer the unilateral right to terminate the franchise on a 90-day notice. The plaintiff is, and

[1] Sue Gilmore is the present wife of plaintiff. They were married on November 1, 1955. Hereafter, any reference to the term "plaintiffs" in the plural number, pertains to the tax year 1955 only and refers to both Don and Sue Gilmore. The singular "plaintiff" refers solely to Don Gilmore.

for many years has been, the president and principal managing officer of each of the three above-mentioned corporations. He has received the following combined gross salaries from them:

| | |
|---|---|
| 1949 | $79,800.00 |
| 1950 | 61,316.65 |
| 1951 | 66,799.92 |
| 1952 | 66,799.92 |
| 1953 | 66,799.92 |

From his ownership of stock he received as dividends:

| | |
|---|---|
| 1948 | $109,484.80 |
| 1949 | 69,438.23 |
| 1950 | 50,663.48 |
| 1951 | 114,625.65 |
| 1952 | 73,044.00 |
| 1953 (D. Gilmore—San Francisco only) | 39,657.02 |

The only income of plaintiff, from sources unrelated to these automobile dealerships for the years in suit was $1,024.90 in 1953, and $516.60 in 1954.

From March 2, 1946 to October 25, 1955, plaintiff was married to one Dixie Gilmore. During all of this time the couple were residents of California. On April 8, 1952, they separated. Two days later, Dixie Gilmore filed for divorce in the Superior Court of the State of California in and for the County of Marin where the parties resided. On June 16, 1952, the plaintiff in the instant case filed an answer to the complaint and a cross-complaint for divorce. This action came to trial, commencing March 16, 1953, and continuing on order until April 24, 1953. The trial court found in favor of Don Gilmore, granting him an interlocutory divorce, denying the divorce to the wife, and decreed that there was no community property of the marriage.

Within the time allowed, Dixie Gilmore appealed this interlocutory judgment to the District Court of Appeals, State of California, First Appellate District. That court, on April 26, 1955, entered its decision reversing the judgment below and ordering a new trial. Thereupon, Don Gilmore petitioned for a hearing of the appeal in the Supreme Court of California. A hearing was granted

in the case, and the decision of the District Court of Appeals was vacated by the Supreme Court, and the judgment of the trial court in all respects affirmed by it [fol. 275] on September 23, 1955. After the Supreme Court had affirmed the interlocutory judgment of divorce, a final judgment of divorce in favor of Don Gilmore and against Dixie Gilmore was entered in the trial court on October 25, 1955. As a result of the protracted litigation proceedings, Mr. Gilmore was required to pay legal fees in the amount of $32,537.15 for the year 1953, $8,074.21 for the year 1954, and approximately $5,300 for the year 1955.

The question of community property was an important one during the divorce proceedings. Prior to plaintiff's marriage in 1946, the value of his stockholdings in the three automobile dealerships was approximately $200,000. At the time of their separation, the value of these stockholdings had risen to approximately $800,000. This is an appreciation of $600,000, and it was the contention of Dixie Gilmore that this appreciation was community property. On this basis she contended that she was entitled to one-half the amount, but she was willing to settle for $275,000.

Plaintiff timely filed his individual income tax return for all three years in question. Among other things, plaintiff took a deduction of 80 percent of the loss of the fees involved in the divorce proceedings as an expense incident to the defending of properties and investments. He also claimed deductions in his returns of the full amount of certain State taxes which were due on his full salary. Plaintiff, because he is an employee, had a certain amount of his wages withheld by his employer. In estimating his tax liabilities for 1953 and 1954, plaintiff credited himself with the full amount withheld.

Upon an audit of plaintiff's 1953 and 1954 individual income tax returns the Commissioner of Internal Revenue made a number of disallowances and adjustments, based on the following determinations:

(a) The principal disallowances resulted from the Commissioner's determination that the attorneys' fees, accountant's fee, court reporters' fees, and printing costs,

which Don Gilmore paid in 1953 and 1954 in connection with the divorce action, were personal expenditures of Don Gilmore and were not deductible under Section 24(a) of the 1939 Internal Revenue Code.

[fol. 276] (b) The Commissioner determined that only $9,762, or one-half of the $19,524 income taxes withheld from Don Gilmore in 1953 should be credited to him, and this resulted in a finding by the Commissioner that $4,881 of the tax liability reported on the 1953 return of Don Gilmore had never been paid.

(c) The Commissioner of Internal Revenue also determined that of the $5,643.10, which Don Gilmore had paid in 1953 for State income and unemployment taxes, Mr. Gilmore was entitled to a credit in his return of only one-half, or $2,821.55, and that the balance was deductible by Dixie Gilmore.

(d) In his 1953 income tax return, Don Gilmore had erroneously reported that, of the $66,799.92 of salaries paid to him during that year, the amount of $50,099.92 was taxable to himself individualy, and the balance of $16,700 was taxable to Dixie Gilmore. The error caused his individual income for the year 1953 to be overstated by the amount of $16,699.96. This error was recognized by the Commissioner of Internal Revenue, who made an adjustment showing that only one-half of the total salaries paid were taxable to Don Gilmore individually.

As a result of various disallowances and adjustments the Commissioner assessed deficiencies in income taxes against plaintiff as follows:

| *Year* | *Tax* | *Interest* | *Total* |
|---|---|---|---|
| 1953 | $18,883.26 | $4,264.25 | $23,147.51 |
| 1954 | 3,762.21 | 583.12 | 4,345.33 |

On November 1, 1955, Don Gilmore and Sue Gilmore were married. When they filed their joint income tax return on April 15, 1956, they claimed a credit for all taxes withheld from Don Gilmore's salary in 1955. In Addition they reported as income the total amount of the salary as their joint income. They filed a timely claim for refund of income taxes paid for the year 1955 on the grounds that income received prior to October 25,

1955, was the community property of Don and Dixie Gilmore and that one-half is taxable to Dixie Gilmore.

The defendant in this case asserts a counterclaim against Don Gilmore for the years 1953 and 1954. As a [fol. 277] result of the Commissioner's adjustments concerning the income tax returns of Dixie Gilmore, it was determined that she had a tax balance due of $3,863.78, plus interest for the year 1953. It was similarly determined that she owed $78.93, plus interest, for 1954. A demand for payment was made on Dixie Gilmore on January 7, 1958. Defendant contends that plaintiff, as the husband of Dixie Gilmore, had full and complete control of the community income and is liable for the income taxes of Dixie Gilmore, together with the interest due thereon.

The issues that present themselves are patently discernable from the foregoing sequence of events and we shall direct our answers in the order that the questions appear.

This court has recently had occasion to review the question of deductibility of legal expenses incurred in divorce litigation. *Davis* v. *United States*, No. 516-58, decided March 1, 1961. In that case the plaintiff attempted to deduct two types of legal fees paid by him; first, legal fees paid for tax advice, and second, legal fees incurred in connection with the protection of income-producing property. This court allowed the deduction as to the first type of legal fees, but denied the deduction as to the second type. In the instant case we are concerned with deductions of the second type; *i.e.*, expenses incurred in connection with the protection of income-producing property.

The general rule is that attorneys' fees paid in connection with a divorce are not deductible. Therefore, in order to bring himself under the section permitting the deduction, plaintiff must show that the legal expenses were incurred in matters directly related to his business or the management, conservation, or maintenance of property held for the production of income. *Port* v. *United States*, 143 Ct. Cl. 334.

Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939, provide:

§ 39.24(a)-1 *Personal and family expenses.* • • • Generally, attorneys' fees paid in a suit for divorce or separate maintenance are not deductible. However, the part of an attorney's fee paid in a divorce or separate maintenance proceeding which is properly attributable to the production or collection of amounts includible in gross income under section 22(k) is deductible under section 23(a)(2). • • •

[fol. 278] In *Davis* v. *United States*, *supra*, we discussed the pertinent cases in this area of the law. We pointed out that there were two groups of cases followed by the courts. One class of authority follows the decision in *Lykes* v. *United States*, 343 U.S. 118, and the other class follows the decision in *Baer* v. *Commissioner*, 196 F. 2d 646. We indicated a belief that it was not necessary to choose which decision is right in the premises because of factual differences in the two lines of cases. We are still of this opinion. However, the facts in the instant case clearly come under the rule laid down by the court in the latter line of cases. At the time of commencement of the divorce proceedings, plaintiff was 62 years of age; he had spent all his adult life in the retail automobile business; he would not have been able to gain employment in some other business, neither could he obtain employment as president or general manager of an automobile dealership, except through a controlling stock ownership interest. The evidence is clear that the large salary paid to plaintiff was not in return for his services rendered, but because he was the controlling stockholder. It is not too difficult to imagine that an irate ex-wife, if she gained control of a corporation, would dispose of her ex-husband as president. Thus, plaintiff was fighting not only to protect his income-producing property, but to prevent the loss of his salary as well.

In addition to the possible loss of his income, and the possible loss of 50 percent or more of the appreciation in the value of the stock, plaintiff could have lost his franchise with the General Motors Corporation through a proviso in the contract permitting a termination in the event of:

Any sale, transfer, relinquishment, voluntary or involuntary, by operation of law or otherwise, of any interest in the direct or indirect ownership or active management of dealership without the prior written approval of Seller.

The sensational nature of the divorce charges of adultery and misconduct, brought by Dixie Gilmore, were published in the local papers. This adverse publicity created a real fear that General Motors might terminate the franchise if the allegations were established and a divorce granted to the wife. Even though Dixie Gilmore took the initiative in raising charges of misconduct, the [fol. 279] plaintiff resisted these charges and brought charges of his own. He did this not because he opposed the idea of his wife obtaining a divorce, as evidenced by the fact that six days after the divorce became final he married again, but because of the consequences that would result from a determination that the charges brought against him were well founded. It is important to notice that under California law, the court must award *more* than 50 percent of the community property, and may award *all* of the community property to the innocent spouse in divorces based on extreme cruelty or adultery. There can be little doubt that Dixie Gilmore sought more than a divorce. If that was all she wanted, she received it at the trial level, but this divorce action went all the way to the Supreme Court of California. Dixie Gilmore wanted a substantial part of the income-producing property of plaintiff.

The Internal Revenue Code of 1939, 26 U.S.C. (1946 Ed.), which was in effect at that time, states:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) Expenses.

. . . . .

(2) Non-trade or non-business expenses.

In the case of an individual, all the ordinary and necessary expenses paid or incurred during the tax-

able year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

Of course it is true that in every divorce case a certain amount of the legal expenses are incurred for the purpose of obtaining the divorce and a certain amount are incurred in an effort to conserve the estate and are not necessarily deductible under section 23(a)(2), but when the facts of a particular case clearly indicate that the property, around which the controversy evolves, is held for the production of income and without this property the litigant might be denied not only the property itself but the means of earning a livelihood, then it must come under the provisions of section 23(a)(2), *supra*. The only question then is the allocation of the expenses to this phase of the proceedings. Here, the plaintiff claims that 80 percent of the legal expenses were incurred [fol. 280] in the conservation of his income-producing property. The commissioner of this court found that at least 80 percent of the legal expenses were so incurred and this is supported by the evidence. The defendant contends that it is the burden of the taxpayer to establish the exact amount to which he is entitled and, if he cannot meet this requirement, then the deduction must be denied. In considering this contention our attention immediately focuses on the landmark case of *Cohan* v. *Commissioner*, 39 F. 2d 540, where Judge Learned Hand directed the court to this question, at page 543:

> • • • The Board refused to allow him any part of this, on the ground that it was impossible to tell how much he had in fact spent, in the absence of any items or details. The question is how far this refusal is justified, in view of the finding that he had spent much and that the sums were allowable expenses. Absolute certainty in such matters is usually impossible and is not necessary; the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making. • • •.

This decision has proved a valuable and workable rule over the years and has withstood the attacks made upon it by the Internal Revenue Service. We are not prepared to sanction an outright frontal attack upon this rule.

We are of the opinion that the evidence presented by the plaintiff is sufficient to support a finding that 80 percent of the legal expenses incurred in this instance were paid in the conservation of income-producing property. Also, we can find no merit in defendant's further contention that the expenses were actually incurred in defense or perfection of title of a capital asset. The stocks in question belonged to plaintiff before he was married and the wife never suggested that he did not hold perfect title to them. In fact, to do so would have defeated her purpose because if he did not have perfect title in the stocks she could not have asserted an interest in the appreciation thereon. Under these circumstances there can be no question that plaintiff has perfect right to the stocks.

Therefore, following the same rationale as in the *Davis* case, *supra*, we reach a contrary conclusion. The facts [fol. 281] in the instant case indicate a situation similar to the facts in *McMurtry* v. *United States*, 132 Ct. Cl. 418; *Baer* v. *Commissioner*, *supra*; *Bowers* v. *Commissioner*, 243 F. 2d 904; and *Fisher* v. *United States*, 157 F. Supp. 364.

We turn next to the question whether the defendant was correct in crediting plaintiff with only one-half of the state taxes paid by him, and one-half of the Federal taxes withheld from his salary for the years 1953 and 1954.

Section 35 of the 1939 Internal Revenue Code provides:

> § 35. *Credit for tax withheld on wages.*
>
> The amount deducted and withheld as tax under Subchapter D of Chapter 9 during any calendar year upon the wages of any individual shall be allowed as a credit to the recipient of the income against the tax imposed by this chapter for the taxable year beginning in such calendar year. • • •

The Regulations then define who the recipient of the income is:

> § 39.35-1. *Credit for tax withheld on wages.*
>
> • • • For the purpose of the credit, the recipient of the income is the person subject to tax imposed under chapter 1 upon the wages from which the tax was withheld. For instance, if a husband and wife domiciled in a State recognized as a community property State for Federal tax purposes make separate returns, each reporting for income tax purposes one-half of the wages received by the husband, each spouse is entitled to one-half of the credit allowable for the tax withheld at source with respect to such wages.

The authority in California is clear that the earnings of the husband continue to be community income until the final judgment of divorce. *Waters* v. *Waters*, 170 P.2d 494. The amounts of these salaries were community income owned equally by Don Gilmore and Dixie Gilmore and one-half of such community income was taxable to Don Gilmore and the other one-half to Dixie Gilmore. In filing his income tax returns for the years 1953 and 1954, the plaintiff arbitrarily attributed a high percentage of the income to himself and a low percentage to his wife. The only way we know that the whole of something may be divided equally into two parts is by dividing [fol. 282] it in half. Therefore, we are of the opinion that the defendant was correct in adjusting plaintiff's tax return to reflect this amount of income. This necessarily brings us to the question of what amount of deductions should be allowed to plaintiff considering that only half of the total salaries was taxable to plaintiff individually. We s[illegible]ain the Government on the issue pertaining to the a[illegible]ount withheld from the salaries. It is apparent that if the salaries are community property, to be divided 50-50, any amount withheld to pay an obligation of both should be considered to have been withheld from each. This is consistent with Treasury Regulation 118, § 39.35-1, and it appears to be a fair and equitable solution to the problem.

On the other hand, the answer to the question of which party is entitled to the deduction for California personal income and unemployment taxes is quite different. The general rule is that a taxpayer cannot deduct taxes "paid or accrued" unless he is legally liable to the authority imposing the tax. The applicable California statute provides:

> § 18555. *Liability of spouses; community income; joint returns.*
>
> The spouse who controls the disposition of or who receives or spends community income as well as the spouse who is taxable on such income is liable for the payment of the taxes imposed by this part of such income. • • •. [California Revenue and Taxation Code (61 West's Ann. Calif. Codes)]

We think this statute establishes the liability of the plaintiff for the state tax responsibilities of his wife. Since plaintiff paid the taxes he is entitled to the deduction. In the case of *Al Jolson*, 3 T.C. 1184, the husband was entitled to deduct the wife's state income taxes which he paid because he was personally liable under the state law.

After these adjustments are made there will remain a tax deficiency on the part of Dixie Gilmore for the years 1953 and 1954. The defendant counterclaims for the amounts of these deficiencies on the basis that they are taxes incurred upon the community income of Don and Dixie Gilmore. We agree that the salaries paid plaintiff during this period were community property, but it does not follow that plaintiff is liable for the tax deficiencies of his wife. In our search of the authorities we have been able to find only two unreported cases that stand [fol. 283] for the proposition that the community property is 100 percent liable for the tax liabilities of one of the parties when they had filed separate returns. *G. J. Rodgers*, 51-2 USTC, ¶ 9495; *R. F. Ruan*, 51-2 USTC, ¶ 9493. The weight of authority is to the contrary. In *Marjorie Hunt*, 22 T.C. 228, the Tax Court stated at page 230:

> * * * For purposes of Federal income taxation, each spouse is equally liable for payment of the tax on his or her respective equal share of the community income. *United States* v. *Malcolm*, 282 U.S. 792 (1931); *Poe* v. *Seaborn*, 282 U.S. 101 (1930). This liability is fixed and definite. It is not a means of splitting income which may be voluntarily chosen or elected to minimize taxes. * * * Her liability for tax ceases only when her interest in the community income ceases. * * *

Again, in *Harrold*, 22 T.C. 625, the court in referring to the two unreported cases mentioned previously stated at page 628:

> * * * It is contrary to a line of cases in which we, and other courts, have held that the powers of management conferred upon the husband by community property laws do not render him personally liable for taxes on his wife's share of the community income. *Poe* v. *Seaborn*, 282 U.S. 101 (1930); *Paul Cavanagh*, 42 B.T.A. 1037 (1940), affirmed on another issue, 125 F. 2d 366 (C.A. 9, 1942); * * * The following explanation given by this tribunal in the *Cavanagh* case, pages 1043 and 1044, adequately answers petitioner's contention:
>
> > The fact that under the California law the husband has a broad power of control does not detract from the wife's interest. This power is conferred upon him merely as the agent of the community and does not make him the owner of all the community property and income, nor negative the wife's present interest there as equal coowner. * * *

Although the *Harrold* case, *supra*, was reversed on factual grounds in *Harrold* v. *Commissioner*, 232 F. 2d 527 (C.A. 9th), the question whether an overpayment refundable to the husband was to be charged with taxes due from the wife was not considered by the Court of Appeals. The whole concept of community property is a legal fiction. It is no more fictitious to say that the wife

earned half the husband's salary by housekeeping than it is to say that each earned half the total income through [fol. 284] their own efforts. Once the law accepts the concept of two individuals each owning an equal half of the income and each individual files a separate return that is the end of it. Each party must be treated as an individual, as if they were not husband and wife. In *Harrold, supra*, the court in attempting to clarify this area of the law emphatically stated at page 629:

> • • • We subsequently emphasized in *H. B. Perine et al., supra*, that we could not require the respondent to do so, stating in part:
>
> > The spouses became separate and distinct taxpayers under the statute upon the filing of separate returns of the community income, and the situation is no different than it would be if the taxpayers were other than husband and wife. They being separate taxpayers, we lack authority to require the respondent to credit the proposed deficiency determined against the wife with an overpayment of tax by the husband. *Alexander Vayssie*, 8 B.T.A. 587. Cf. *John W. Preston*, 21 B.T.A. 840.

The defendant cites *Clayton* v. *United States*, 70 Ct. Cl. 740, cert. denied, 283 U.S. 860, and *Lattimore, et al.* v. *United States*, 82 Ct. Cl. 97, as supporting the allocation of an overpayment by one spouse to a deficiency of the other. However, in each of those cases the taxpayers originally filed a joint return, indicating that the amount paid with the joint return was intended to be applied to the tax liabilities of each. The defendant also relies on another decision of this court, *Santos* v. *United States*, No. 433—58, decided May 4, 1960, 277 F. 2d 806. The obvious distinction is in that case the law applicable was the Hawaiian Code which made the community property liable, not the California Code, and as the defendant points out in its brief:

> Legal rights, liabilities and interests of husband and wife are created by state law, and the Federal

revenue laws determine how the interests and liabilities as created shall be subject to income taxes. *Trapp* v. *United States*, 177 F. 2d 1 (C.A. 10th).

As a consequence of the above-stated reasons, we find that the defendant is not entitled to recover on its counterclaim.

This brings us to the last issue concerning plaintiff's liability for 1955. The Government concedes that the salaries of plaintiff from Jaunary 1, 1955 to October 25, [fol. 285] 1955, were community income to him and Dixie Gilmore at the time the divorce became final. Therefore, plaintiffs were required to include only one-half the income received during this period in their 1955 joint tax return. It should be mentioned in passing that the tax return of Dixie Gilmore for 1955 does not indicate a tax deficiency; in fact, there is an overassessment of $1,895.76, which the defendant might apply against Dixie Gilmore's tax deficiencies for 1953 and 1954.

It is so ordered.

DURFEE, *Judge*; MADDEN, *Judge*; WHITAKER, *Judge*; and JONES, *Chief Judge*, concur.

## FINDINGS OF FACT

The court, having considered the evidence, the report of Trial Commissioner Wilson Cowen, and the briefs and argument of counsel, makes findings of fact as follows:

1. Plaintiffs are and since November 1, 1955, have been husband and wife. They are citizens and residents of California.

2. From March 2, 1946 to October 25, 1955, plaintiff Don Gilmore was married to one Dixie Gilmore. During all of their marriage, Don Gilmore and Dixie Gilmore were residents of California.

3. On April 8, 1952, Don Gilmore and Dixie Gilmore were separated after six years, one month and six days of childless marriage. On April 10, 1952, Dixie Gilmore filed a complaint for divorce against Don Gilmore in the Superior Court of the State of California in and for the County of Marin, where the parties resided. On June 16,

1952, Don Gilmore filed an answer to this complaint and a cross-complaint for divorce against Dixie Gilmore. This action came to trial in due course in the Superior Court, commencing March 16, 1953, and continuing in order until April 24, 1953. The trial court found the issues in favor of Don Gilmore, denied Dixie Gilmore a divorce from Don Gilmore, and granted Don Gilmore an interlocutory judgment of divorce from Dixie Gilmore, wherein it decreed that there was no community property of the marriage, adjudged two residences to be joint tenancy property of the parties, and determined contrary to her claims that Dixie Gilmore had no community interest in [fol. 286] certain property, more specifically described hereafter, which stood of record as the separate property of Don Gilmore.

4. Dixie Gilmore appealed from this interlocutory judgment to the District Court of Appeal, State of California, First Appellate District. That court on April 26, 1955, entered its decision reversing the judgment below and ordering a new trial. Thereupon respondent Don Gilmore petitioned for a hearing of the appeal in the Supreme Court of the State of California. A hearing was granted in the case, and the decision of the District Court of Appeal was vacated by the Supreme Court, and the judgment of the trial court in all respects affirmed by it on September 23, 1955. The decision of the Supreme Court is reported at 45 Cal. 2d 142.

5. After the Supreme Court of California had affirmed the interlocutory judgment of divorce, a final judgment of divorce in favor of Don Gilmore and against Dixie Gilmore was entered in the Superior Court of the State of California in and for the County of Marin on October 25, 1955.

6. In his divorce litigation with Dixie Gilmore plaintiff Don Gilmore was represented at all times by Michael L. Haun, Esquire, of the California bar, and from the outset of the litigation until about March 13, 1953, also by Walter F. Freitas, Esquire, of the law firm of Freitas, Freitas & Allen. From January or February 1953, until the conclusion of this litigation, plaintiff Don Gilmore was also represented therein by Wallace S. Myers, Esquire, of

the law firm of Myers & Meehan. Dixie Gilmore's attorney's in said litigation from its inception until August 18, 1953, were Leslie C. Gillen, Esquire, and Charles A. Christin, Esquire. After that date and until the end of the litigation, her attorneys were James Martin MacInnis, Esquire, and Nicholas Alaga, Esquire.

7. When Dixie Gilmore commenced her action for a divorce against plaintiff Don Gilmore on April 10, 1952, and when that action was tried, Don Gilmore individually was the record owner of the following securities:

(a) 3,000 shares of the common stock of Don Gilmore—San Francisco, a California corporation, being 100 percent of the issued and outstanding stock of said corporation;

[fol. 287] (b) 1,500 shares of the common stock of Don Gilmore—Riverside, a California corporation, being 60 percent of the issued and outstanding stock of said corporation. The remaining shares of stock of this corporation were then owned by Thomas E. Brady and H. J. McCullough.

(c) 1,833 1/3 shares of the common stock of Don Gilmore—Hayward, a California corporation, being 73 1/3 percent of the issued and outstanding stock of said corporation. The remaining shares of stock of this corporation were then owned by C. N. Wilson and H. J. McCullough.

All of his stock interests in these corporations had been owned by Don Gilmore continuously since a date prior to his marriage to Dixie Gilmore.

8. For many years prior to the divorce litigation and during that litigation, Don Gilmore—San Francisco (a corporation), was engaged in the business of operating a franchised Chevrolet dealership for the retail sale and servicing of new and used automobiles and trucks in San Francisco, California. During the same period, Don Gilmore—Riverside (a corporation), carried on a like business as a franchised Pontiac dealership in Riverside, California, and Don Gilmore—Hayward (a corporation), carried on a like business as a franchised Chevrolet dealership in Hayward, California. Each of these businesses

operated under an annually renewable franchise contract with a division of General Motors Corporation; each franchise contract contained a clause giving the manufacturer the unilateral right to terminate the franchise on 90 days' notice.

9. For many years prior to the trial of the divorce action between Dixie Gilmore and himself, plaintiff Don Gilmore had been the president and principal managing officer of each of the three above-mentioned corporations. He had received the following combined gross salaries from them:

| | |
|---|---|
| 1949 | $79,800.00 |
| 1950 | 61,316.65 |
| 1951 | 66,799.92 |
| 1952 | 66,799.92 |

10. In 1953, the year in which the divorce action was tried, Mr. Gilmore received salaries as president of the three corporations in the total combined amount of $66,799.92, broken down as follows:

[fol. 288]

| | |
|---|---|
| San Francisco | $49,999.92 |
| Hayward | 10,800.00 |
| Riverside | 6,000.00 |

11. From his ownership of stock in the foregoing corporations Don Gilmore had received the following dividends in recent years prior to 1953:

| | |
|---|---|
| 1948 | $109,484.80 |
| 1949 | 69,438.23 |
| 1950 | 50,663.48 |
| 1951 | 114,625.65 |
| 1952 | 73,044.00 |

In 1953 Don Gilmore received a dividend from Don Gilmore—San Francisco, in the amount of $39,657.02.

12. The only income of Don Gilmore from sources unrelated to these automobile dealerships for the years in suit was $1,024.90 in 1953, and $516.60 in 1954.

13. The salaries paid to Don Gilmore by three automobile dealerships, and particularly the large portion

thereof paid to him by Don Gilmore—San Francisco, were generous for the services he performed. He was paid these salaries only because of his controlling stock ownerships in these corporations. His salaries for corresponding positions would have to be greatly reduced if he were employed by corporations which he did not own outright or control.

14. Don Gilmore had spent all of his adult life in the retail automobile business. This was the only business he knew. In 1952 and 1953, he was 62 years of age, and too old to get another job as president or general manager of an automobile dealership, except through a controlling stock ownership interest.

15. Among the provisions of the automobile dealerships' franchise contracts was a Minimum Capital Standard Agreement, by which the manufacturer required each dealership to maintain a stated minimum of total owned capital. In the case of Don Gilmore—San Francisco, the total owned capital required by the Chevrolet Division of General Motors Corporation for the year commencing November 1, 1954, was $556,283. As of July 31, 1954, the total owned capital of that corporation was $626,486, all of which was owned by Don Gilmore individually.

16. The franchise contracts also provided that the General Motors Corporations could immediately terminate [fol. 289] the franchises by delivering to the dealer or his representative a written notice of termination in the event of:

> Any sale, transfer, relinquishment, voluntary or involuntary, by operation of law or otherwise, of any interest in the direct or indirect ownership or active management of dealership without the prior written approval.

17. Shortly after Don and Dixie Gilmore first separated about April 8, 1952, Mr. Haun, Mr. Gilmore's attorney, had one or two discussions with Mrs. Gilmore's attorney in an effort to determine whether there was a possibility of saving the marriage. However, it was soon evident that there was no possibility of a reconciliation, and no further efforts to save the marriage were made after April 15, 1952.

18. In May 1952, Don Gilmore had accepted the fact that his marriage to Dixie was beyond repair. He was willing to have a divorce granted to Dixie and to pay her a reasonable amount of alimony for a reasonable period. In principle, Dixie's demands that she should obtain the divorce and that she should receive an appropriate amount of alimony were acceptable to Don Gilmore and to his counsel.

19. At the time of his marriage to Dixie Gilmore in 1946, the value of Don Gilmore's stockholdings in the three automobile dealerships was approximately $200,000. At the time of their separation, the total value of these stockholdings had risen to approximately $800,000.

In 1952 and prior to the trial of the divorce suit, Michael Haun and, subsequently, Walter F. Freitas, as attorneys for Don Gilmore, had conferences with Messrs. Gillen and Christin, who represented Dixie Gilmore, in an effort to settle the litigation. In each of these conferences, Dixie's attorneys took the position that the increase of approximately $600,000 in the value of Don Gilmore's stockholdings was money earned by virtue of his personal services to the corporations and, therefore, was community property under the laws of California. On this basis, they contended that Dixie Gilmore was entitled to one-half of the value of the increase but stated that if Don Gilmore would pay Dixie Gilmore $275,000 in cash, she would accept that in full settlement of her claim. [fol. 290] During the divorce trial, Dixie Gilmore sought to recover $300,000 as her community share of the $600,000 increase in the value of the stock.

20. Don Gilmore rejected Dixie Gilmore's demands for a settlement payment of $275,000 for the following reasons:

(a) It would have been impossible for him to raise $275,000 in cash without selling a substantial portion of his stocks in the automobile dealerships. In the event of the sale of sufficient stock to raise that amount, his capital investment in the dealerships would have been reduced below the minimum capital standards required in his dealer franchise contracts, and he feared that such a

reduction would result in the cancellation of the franchises.

(b) Although Dixie Gilmore's attorneys stated that she would accept stock in lieu of cash in payment of the settlement, Don Gilmore feared that the General Motors Corporation would not accept Dixie Gilmore as a shareholder in the corporations and would cancel the franchise contracts pursuant to the contract provision quoted in finding 16.

(c) His attorneys advised Don Gilmore that any increase in the value of the separate property of a spouse as a result of his personal efforts or services during marriage was recognized by California law as community property, but that any increase in value of the stocks due to a return on the investment remained separate property. After examining his books and records, his attorneys further advised him that they had determined that during the marriage he had drawn salaries from the corporations in amounts which the attorneys felt were the maximum salaries that the Internal Revenue Service would recognize as reasonable compensation for managing officers of automobile dealerships and that all of the proceeds of the salaries had been spent by Don Gilmore and Dixie during their marriage. Accordingly, they advised him that any additional increment of value accruing to his shares of stock in the dealerships during the marriage was his separate property and not community property.

21. After the efforts to settle failed, the action went to trial in the Superior Court. The trial consumed a period of 24 days, and the reporter's transcript of the case consisted of 11 volumes containing 3,063 pages.

[fol. 291] 22. With respect to the issues before him, the trial judge made the following statement:

> The primary issue here, aside from the divorce itself, is the question of the evaluation and determination of the defendant's separate or community property first, most noteworthy the claim set forth by Mr. Gilmore and his counsel that the increase, balance sheet increase, the increase in net worth, that is, overall net worth of his interest in the agencies represented by his holdings.

23. The issue as to which party was entitled to be granted the divorce arose out of allegations by Dixie Gilmore that Don Gilmore was guilty of extreme cruelty and adultery and by the allegations of his cross-complaint that she had been guilty of a continuous course of misconduct that constituted extreme cruelty. The evidence, including the transcript of the evidence at the divorce trial, reflects that the major portion of the evidence presented by both parties and the time required for its presentation were devoted to the misconduct charges. A considerably smaller portion of the evidence related to the question of whether the increase in the value of Don Gilmore's stock was community property.

However, after Dixie Gilmore took the initiative in raising charges of misconduct on the part of Don Gilmore, his attorneys determined that it was necessary to resist these charges by extensive examination of Dixie Gilmore, by rebuttal evidence, and by evidence of misconduct on the part of Dixie Gilmore, for the following reasons:

(a) Under California law, the court must award more than 50 percent of the community property, and may award all of the community property to the innocent spouse in divorces based on extreme cruelty or adultery, the grounds alleged by Dixie Gilmore.

(b) The credibility of the parties became an important factor in the evaluation by the trial court of the entire case, including both the misconduct and community property issues. Don Gilmore's attorneys feared that if the trial judge believed Dixie's charges, he might also find that there was community property and award all or most of it to her.

(c) There was an issue as to whether oral declarations and conduct between the parties had affected the nature of the property in dispute.

[fol. 292] (d) Dixie Gilmore's charges of misconduct by Don Gilmore were published in the local newspapers. As a result, Don Gilmore feared that if the allegations were established and a divorce based on such charges was granted to Dixie Gilmore, the General Motors Corpora-

tion might cancel his dealership franchises. Although the evidence does not show whether or not his fears were justified, he and his attorneys felt it necessary to refute Dixie Gilmore's accusations and to [illegible] misconduct on her part.

24. In preparation for and during the trial of the divorce suit, Don Gilmore's attorneys devoted considerable effort in establishing that no portion of the increase in the value of his stock constituted community property. The most important evidence presented by Mr. Gilmore's attorneys on the community property issue consisted of (a) proof that the salaries paid him by the corporations in which he owned stock represented more than ample compensation for the services he rendered as an officer of these corporations, and (b) proof presented through a certified public accountant that the community obligations and expenses that had been paid during the marriage exceeded the salaries and other community income that Don Gilmore had earned during the marriage.

25. In addition to the principal issues described above, the questions of whether Dixie Gilmore was entitled to alimony and whether two houses in which the parties had lived were held in joint tenancy were also before the court in the divorce action. Before the trial began, Don Gilmore's attorneys anticipated that the court would direct the payment of alimony to Dixie Gilmore for a period of two or three years, since that had been the usual practice of many of the Superior Court judges in divorce actions where the marriages were of short duration. The evidence shows that little time and effort were devoted by Don Gilmore's attorneys on the alimony issue. Although there was a question as to whether two residences in which the parties had lived were held in joint tenancy, very little evidence was required to dispose of the matter, because the deeds to the properties were admitted in evidence and showed, as the court held, that the houses were in fact held in joint tenancy by Don and Dixie Gilmore.

[293] 26. As shown by the decision of the California Supreme Court in *Gilmore* v. *Gilmore*, 287 P. 2d 769, there were two methods which had been used by the Cali-

fornia courts in making an allocation between community and separate property. One method (the one urged by Dixie Gilmore's attorneys) for determining what part of an increase in the value of a business is community property is to subtract from the total increase a reasonable return on the value at the time of the marriage and treat the remainder as community property.

The other method—advocated by Don Gilmore's attorneys and adopted by the trial court—is to deduct from the total earnings of the business the value of the husband's services to it. The remainder, if any, represents the earnings attributable to the separate property invested in the business. The trial court's decision in this respect was affirmed by the California Supreme Court on the basis of the trial court's findings that Don Gilmore's corporations were staffed by well trained personnel who were capable of carrying on the businesses unassisted; that he worked relatively short hours and took many extended vacations; that the salaries he received, constituting community income, were more than ample compensation for the services he rendered, and that during the period involved there was a tremendous increase in the automobile business that was accompained by an increase in the value of dealer franchises.

27. After Dixie Gilmore appealed from the interlocutory decree rendered by the Superior Court, it was necessary for Michael L. Haun and Wallace S. Myers, as Don Gilmore's attorneys, to spend considerable effort, research, thought, and planning on the appellate proceedings and to write briefs and make arguments before the appellate courts during 1953, 1954, and 1955. A reversal of the trial court's decision or the granting of a new trial would have deprived their client of the success achieved at the trial.

28. During 1953 and 1954, Don Gilmore paid the following amounts for work or services rendered by his attorneys and others in connection with the divorce litigation:

[fol. 294]

*1953*

| | |
|---|---|
| Michael L. Haun, attorney | $8,281.50 |
| Walter F. Freitas, attorney | 3,500.00 |
| Wallace S. Myers, attorney | 14,265.00 |
| R. L. Schwerin, C.P.A. | 1,500.00 |
| Court reporters | 4,990.65 |
| Total | 32,537.15 |

*1954*

| | |
|---|---|
| Michael L. Haun, attorney | $5,250.00 |
| Wallace S. Myers, attorney | 2,000.00 |
| Pernau-Walsh Printing Co. (briefs on appeal) | 804.21 |
| Court reporter | 20.00 |
| Total | 8,074.21 |

(a) When Dixie Gilmore appealed from the interlocutory judgment, Don Gilmore was ordered by the trial court to pay for a transcript of the trial proceedings and paid the $4,990.65 listed above to two court reporters for their preparation of the transcript.

(b) In connection with the trial of the divorce action, Don Gilmore's attorneys retained on their client's behalf Robert Schwerin, a certified public accountant, who made an examination of Don Gilmore's books and prepared accounting schedules showing that the community expenses of Don and Dixie Gilmore during their marriage were greater than his salaries and other community income during the same period. The schedules were admitted in evidence in connection with Mr. Schwerin's testimony in the divorce suit. He was paid a fee of $1,500 for the services he rendered for Don Gilmore.

(c) Walter F. Freitas is an attorney who represented Don Gilmore after the divorce suit was filed, but he withdrew from the case shortly before it went to trial. He represented Mr. Gilmore in the negotiations for settlement and in the taking of depositions before the trial itself began. Don Gilmore paid him $3,500 for the legal services he rendered in this connection in 1953.

(d) Michael L. Haun served as Mr. Gilmore's attorney from date of the filing of the divorce action until the final judgment was entered after the decision of the California Supreme Court on appeal.

(e) Wallace S. Myers, an attorney, was employed by Mr. Gilmore to represent him about February 1953, after [fol. 295] the divorce suit was filed, and he continued with Mr. Haun to represent Mr. Gilmore thereafter throughout the trial and appeal of the case, until final judgment was entered.

(f) As indicated in the foregoing table, the sum of $804.21 was paid by Don Gilmore in 1954 to the Pernau-Walsh Printing Co. for printing briefs on the appeals from the interlocutory decree of divorce.

(g) Don Gilmore also paid $20 to a court reporter for services rendered in connection with the divorce litigation in 1954.

29. None of the three attorneys who represented Don Gilmore kept records in which he undertook to allocate what percentage of his time or efforts was devoted to each of the several issues involved in the divorce litigation. However, each of them testified that more than 80 percent of the legal services which they rendered and for which they were paid by Don Gilmore in 1953 and 1954 were directed toward preserving his stock in the three dealerships as his separate property and in defeating Dixie Gilmore's claim that she was entitled to one-half of the increment in the value of that stock that occurred during the marriage. The attorney who represented Dixie Gilmore in the appeals testified that he was unable to determine the percentage of effort that the attorneys for either side devoted to the several issues, because the factual issues regarding misconduct and community property merged and overlapped in view of the fact that the California law requires the court to award more than 50 percent of the community property to the innocent spouse in cases where a divorce decree is awarded on grounds of adultery or extreme cruelty.

If Dixie Gilmore had succeeded in obtaining the community interest she claimed in the stock of the automobile corporations and the dealership contracts held by Don Gilmore had been canceled because of his failure to maintain the minimum ownership of capital required by such contracts, he would have lost his positions and salaries as an officer of the corporations and, as stated in finding

14, he was too old at the time to get a similar position with other automobile dealers.

30. The evidence, particularly the facts set forth in finding 23, establishes that 80 percent or more of the [fol. 296] amounts which Don Gilmore paid to his attorneys and his accountant in 1953 and to his attorneys in 1954 were for services rendered by them to defeat Dixie Gilmore's claims to one-half of the value of the increase of his stock in the three dealership corporations, and to establish that no portion of such stock was community property.

31. (a) Don Gilmore timely filed his individual income tax return for the calendar year 1953 with the District Director of Internal Revenue at San Francisco. Mr. Gilmore reported a total tax liability of $18,209.86 and further reported that of this sum, $14,643 had been paid as income taxes withheld from his salaries by his employers and by excess F.I.C.A. tax payments. By this computation, there was a balance due of $3,566.86, which he paid with his return.

(b) His 1953 tax retrun reflected the following allocations of salaries received and taxes withheld:

| INCOME: | | *Don* | *Dixie* |
|---|---|---|---|
| *Salaries:* | *Total* | *Gilmore* | *Gilmore* |
| Don Gilmore, San Francisco | $49,999.92 | | |
| Don Gilmore, Hayward | 10,800.00 | | |
| Don Gilmore, Riverside | 6,000.00 | | |
| | 66,799.92 | $50,099.92 | $16,700.00 |
| Parties divorced. | | | |
| Community status through 7-1-53. | | | |
| *Allocation of Withholding Tax:* | | | |
| Don Gilmore, San Francisco | $15,000.00 | | |
| Don Gilmore, Hayward | 3,240.00 | | |
| Don Gilmore, Riverside | 1,176.00 | | |
| Excess F.I.C.A. Tax | 108.00 | | |
| | 19,524.00 | 14,643.00 | 4,881.00 |

(c) Among others, Don Gilmore took a deduction in his 1953 income tax return in the sum of $31,377.20 for "Costs of defending properties & investments. Legal fees and accounting costs".

(d) In his 1953 tax return, Mr. Gilmore also claimed deductions for the following taxes which he allocated as follows:

| | *Total* | *Don Gilmore* | *Dixie Gilmore* |
|---|---|---|---|
| California income taxes | $5,643.10 | $4,691.22 | $951.88 |
| Unemployment tax | 30.00 | 22.50 | 7.50 |

[fol. 297] 32. (a) Don Gilmore timely filed his individual income tax return for the calendar year 1954 with the District Director of Internal Revenue at San Francisco, reporting a tax liability of $7,098.71, taxes withheld of $11,879.67, and an overpayment of income taxes for the year in the sum of $4,781.84.

(b) Among the deductions claimed in his 1954 return, was one in the sum of $6,499.37 for "Costs of defending properties and investments—legal fees".

(c) In the same return he also reported the payment and allocation of the following State income and unemployment taxes:

| *Taxes:* | *Total* | *Don Gilmore* | *Dixie Gilmore* |
|---|---|---|---|
| State Income Tax | $1,492.84 | $1,492.84 | |
| State Income Tax additional—1950-51 | 982.11 | 491.06 | $491.05 |
| Unemployment tax | 30.00 | 15.00 | 15.00 |

33. Upon an audit of Don Gilmore's 1953 and 1954 individual income tax returns, the Commissioner of Internal Revenue made a number of disallowances and adjustments, including the following:

(a) The principal disallowances resulted from the Commissioner's determination that the attorneys' fees, accountant's fee, court reporters' fees, and printing costs, which Don Gilmore paid in 1953 and 1954 in connection with the divorce action, were personal expenditures of

Don Gilmore and were not deductible under Section 24(a) of the 1939 Internal Revenue Code.

(b) The Commissioner determined that only $9,762, or one-half of the $19,524 income taxes withheld from Don Gilmore in 1953 should be credited to him, and this resulted in a finding by the Commissioner that $4,881 of the tax liability reported on the 1953 return of Don Gilmore had never been paid.

(c) The Commissioner of Internal Revenue also determined that of the $5,643.10, which Don Gilmore had paid in 1953 for State income and unemployment taxes, Mr. Gilmore was entitled to a credit in his return of only one-half, or $2,821.55, and that the balance was deductible by Dixie Gilmore.

(d) In his 1953 income tax return, Don Gilmore had erroneously reported that of the $66,799.92 of salaries [fol. 298] paid to him during that year, the amount of $50,099.92 was taxable to himself individually and the balance of $16,700 was taxable to Dixie Gilmore. The error caused his individual income for the year 1953 to be overstated by the amount of $16,699.96. This error was recognized by the Commissioner of Internal Revenue, who made an adjustment showing that only one-half of the total salaries paid were taxable to Don Gilmore individually.

34. As a result of various disallowances and adjustments (including some not now in dispute), the Commissioner assessed deficiencies in income taxes against Don Gilmore as follows:

| *Year* | *Tax* | *Interest* | *Total* |
|---|---|---|---|
| 1953 | $18,883.26 | $4,264.25 | $23,147.51 |
| 1954 | 3,762.21 | 583.12 | 4,345.33 |

Such deficiencies in taxes were paid by Don Gilmore on November 15, 1957, and the interest thereon was paid November 27, 1957.

35. Don Gilmore and Sue Gilmore were married on November 1, 1955, and on April 15, 1956, they filed with the District Director of Internal Revenue at San Francisco their joint income tax return for the calendar year 1955, showing a tax liability of $10,137.52, claiming withholding tax and estimated tax credits of $22,203.21, and

asserting an overpayment of $12,065.69. In the return, the taxpayers requested that the overpayment be credited on their 1956 estimated income tax.

36. (a) In the 1955 tax return, Don and Sue Gilmore reported the following:

| *Employer:* | *Wages, etc.* | *Income Tax Withheld* |
|---|---|---|
| Don Gilmore, San Francisco | $20,583.29 | $7,583.29 |
| Don Gilmore Hayward | 16,800.00 | 6,126.00 |
| Don Gilmore, Riverside | 10,800.00 | 3,544.08 |
| Excess FICA | ..... | 168.00 |
| | 48,183.29 | 17,421.37 |

This return includes all earnings of Don Gilmore during 1955 over which he had complete control, including any share thereof which Dixie Gilmore, his divorced wife, may possibly claim as her share of community income for the period January 1, 1955 to and including the date of the final decree of divorce in October 1955.

[fol. 299] (b) In the 1955 return, they also took a deduction of $4,236.66 for "Costs of defending properties and investments—Legal Fees."

(c) As shown by the above-quoted table, the taxpayers in their 1955 return claimed a credit for all taxes withheld from Don Gilmore's salaries in 1955, including the amount withheld prior to October 25, 1955, when the final decree of divorce was entered, as well as the taxes withheld between that date and the end of the calendar year.

37. Don Gilmore received the amount of $42,433.29 as salaries from his employers, Don Gilmore—San Francisco, a corporation, Don Gilmore—Hayward, a corporation, and Don Gilmore—Riverside, a corporation, after December 31, 1954 and prior to October 25, 1955.

In addition Don Gilmore received on October 31, 1955, the following amounts as salaries from his employers for the period from October 16, 1955 to October 31, 1955:

| | |
|---|---|
| From Don Gilmore—Hayward, a corporation | $700.00 |
| From Don Gilmore—Riverside, a corporation | 450.00 |

In addition, Don Gilmore received the amount of $4,600 as salaries from his employers after October 31, 1955, and prior to January 31, 1956.

38. On the basis of the decision in *Waters* v. *Waters*, 170 P. 2d 494 and other authorities, it is the plaintiffs' position herein that all 1955 salaries earned by Don Gilmore prior to October 25, 1955, when the final decree of divorce was entered, were community income of Don Gilmore and Dixie Gilmore. Thus, according to plaintiffs' computation, the $42,433.29 which Don Gilmore earned as salaries from January 1 to October 16, 1955, was community income and that $718.75 of the $1,150 in salaries which he earned in the period from October 16, 1955 to October 31, 1955, is also community income of Don Gilmore and Dixie Gilmore. Plaintiffs' addition of the two amounts yields a total of $43,152.04 as the total 1955 community income of Don and Dixie Gilmore.

39. The taxpayer, Don Gilmore, filed a timely claim for refund of income taxes paid for the year 1953 on the following grounds:

[fol. 300] 1. 80% of expenses for legal fees of taxpayer's attorneys, and of other costs in divorce proceedings (except fees paid to attorneys for Dixie Gilmore), were incurred and paid during the taxable year for the conservation of the taxpayer's income-producing property. They are therefore deductible expenses. They were erroneously treated by the Commissioner as personal expenditures.

2. The Commissioner had erroneously credited to Dixie Gilmore, and refused to credit to the taxpayer, amounts of income tax withheld from the taxpayer's salary by his employer and which were deposited by taxpayer's employer to the taxpayer's credit with the District Director of Internal Revenue.

3. The Commissioner has erroneously allocated to Dixie Gilmore, and refused to allow as a deduction from the taxpayer's gross income, income taxes paid to the State of California by the taxpayer for his account and not for that of Dixie Gilmore, in the amount of $1,877.17.

4. The Commissioner has erroneously credited to Dixie Gilmore, and disallowed as an expense of the taxpayer, amounts of unemployment insurance tax

paid for the taxpayer's account to the State of California. These amounts were expenses of the taxpayer and were not paid for or expenses of Dixie Gilmore.

40. The taxpayer, Don Gilmore, filed a timely claim for refund of income taxes paid for the year 1954 on the following grounds:

> 80% of expenses for legal fees of taxpayer's attorneys, and of other costs in divorce proceedings, were incurred for the conservation of the taxpayer's income-producing property. They are therefore deductible. They were erroneously treated by the Commissioner as personal expenditures.

41. The taxpayers, Don and Sue Gilmore, filed a timely claim for refund of income taxes paid for the year 1955 on the following grounds:

> Don Gilmore was previously married to Dixie Gilmore, and this marriage was dissolved by a final decree of divorce effective Oct. 25, 1955. Wages, etc. paid to Don Gilmore between Jan. 1 and Oct. 25, 1955, were community income of Don Gilmore and Dixie Gilmore, of which one-half is taxable to Dixie Gilmore. The present taxpayers, Don and Sue Gilmore, erroneously reported all of such income as their community income, and are filing this claim to [fol. 301] eliminate from their gross income the portion thereof which is taxable to Dixie Gilmore.

42. More than 6 months had elapsed after the filing of the above-described claims for refund before this action was brought. No action had been taken by the Commissioner of Internal Revenue on the claims for refund by that time.

DEFENDANT'S COUNTERCLAIM

43. Defendant was granted permission to assert at the trial a counterclaim against Don Gilmore for each of the years 1953 and 1954 for unpaid income taxes assessed against Dixie Gilmore for those years. The counterclaim was filed December 15, 1959, and the allegations thereof were denied plaintiff Don Gilmore.

44. Shortly prior to June 19, 1957, an Internal Revenue agent prepared delinquent income tax returns for Dixie Gilmore for the years 1953 and 1954. The agent did not discuss the contents of the returns with Dixie Gilmore, but prepared such returns on the basis of a report made by another Internal Revenue agent who had examined the income tax returns of Don Gilmore for the years 1953 and 1954. After the returns for Dixie Gilmore had been prepared, they were mailed to her for signature, and on June 19, 1957, her then attorney delivered the returns, which had been signed by Dixie Gilmore, to the Internal Revenue Service and they were filed on that date.

The total tax liability reflected by the return for Dixie Gilmore for 1953 was $13,625.78. Against this liability a credit for income tax withheld in the amount of $9,762 was applied, leaving a balance of tax due in the amount of $3,863.78. On December 31, 1957, interest up to that date in the amount of $879.51 was assessed, making a total balance then due of $4,743.29.

The return for Dixie Gilmore for 1954 reflected a total tax liability of $11,958.59. A credit of $11,879.66 for income taxes withheld was applied, thus leaving a balance of $78.93 due for 1954 income taxes. On December 31, 1957, interest of $13.23 was assessed, making a total of $92.16 due as of that date.

[fol. 302] 45. A demand for the payment of the 1953 and 1954 income taxes and interest was first made on Dixie Gilmore on January 7, 1958, and on March 28, 1958, tax liens were filed against Dixie Gilmore for the unpaid income taxes, plus interest, in Napa County, California. The record does not show what additional attempts if any, have been made to collect such taxes from Dixie Gilmore.

46. Defendant's counterclaim is based on its contention that during the years 1953 and 1954, Don Gilmore, as the husband of Dixie Gilmore, had full and complete control of the community income and is liable for the unpaid income taxes of Dixie Gilmore, together with the interest due thereon.

47. The final judgment of divorce entered by the Superior Court of Marin County, California, on October

25, 1955, in *Dixie Gilmore* v. *Don Gilmore*, provided in part:

> It is Further Ordered, Adjudged and Decreed that there is no community property belonging to the parties hereto.

48. When the 1953 and 1954 individual income tax returns of Don Gilmore were reviewed and audited by the Internal Revenue Service (finding 33), the report of examination (Exhibit 21), stated that since the interlocutory decree of divorce of June 30, 1953, did not adjudicate community property income rights for the interlocutory period, salaries earned during the interlocutory period constituted community property income and that one-half of such income was legally the income of the taxpayer's former spouse, Dixie Gilmore. As shown in finding 33(d), the Internal Revenue Service adjusted Don Gilmore's 1953 return so as to show that only one-half of the total salaries he received that year was taxable to him individually.

49. On or about October 25, 1955, when the final decree of divorce was entered, the attorneys who represented Dixie Gilmore on appeal demanded an accounting of any accumulations of community property during the period between the interlocutory decree of June 30, 1953, and the final decree of October 25, 1955. It was established at that time that the community income during the period involved was considerably less than payments made by Don Gilmore for community expenses and obligations.

[fol. 303] Conclusion of Law

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiff is entitled to recover, and judgment will be entered to that effect.

The court further concludes as a matter of law that the defendant is not entitled to recover and, accordingly, its counterclaim is dismissed.

The amount of recovery will be determined pursuant to Rule 38(c), of the Rules of this court.

[fol. 304] Clerk's Certificate to foregoing transcript omitted in printing

[fol. 305]

SUPREME COURT OF THE UNITED STATES

No. 255, October Term, 1961

UNITED STATES, PETITIONER

vs.

DON GILMORE ET AL.

ORDER ALLOWING CERTIORARI October 9, 1961

The petition herein for a writ of certiorari to the United States Court of Claims is granted. The case is transferred to the summary calendar and set for argument immediately following Nos. 190 and 268.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

U. S. GOVERNMENT PRINTING OFFICE 1961 820914

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# In the Supreme Court of the United States

OCTOBER TERM, 1961

No. —

UNITED STATES, PETITIONER

*v.*

DON GILMORE AND SUE GILMORE

*PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS*

The Solicitor General, on behalf of the United States, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Claims in this case.

## OPINION BELOW

The opinion below (Appendix, *infra*, pp. 13–25) has not yet been officially reported.

## JURISDICTION

The judgment of the Court of Claims was entered on June 7, 1961. (Appendix, *infra*, pp. 13, 25.) The jurisdiction of this Court is invoked under 28 U.S.C. 1255.

## QUESTION PRESENTED

Whether legal expenses incurred in a divorce proceeding are deductible, for income tax purposes, as

expenses paid in the conservation of income-producing property.

## STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> (a) *Expenses.*—
>
> * * * * *
>
> (2) [as added by Section 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, 819] *Non-trade or non-business expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.
>
> * * * * *
>
> (26 U.S.C. 1952 ed., Sec. 23.)

Section 212 of the Internal Revenue Code of 1954 is similar.

> SEC. 24. ITEMS NOT DEDUCTIBLE.
>
> (a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—
>
> (1) [as amended by Section 127(b) of the Revenue Act of 1942, *supra*] Personal, living, or family expenses, except * * *.
>
> * * * * *
>
> (26 U.S.C. 1952 ed., Sec. 24.)

Section 262 of the Internal Revenue Code of 1954 is similar.

Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939:

> SEC. 39.24(a)-1. *Personal and family expenses.*—* * * Generally, attorneys' fees paid in a suit for divorce or separate maintenance are not deductible. However, the part of an attorney's fee paid in a divorce or separate maintenance proceeding which is properly attributable to the production or collection of amounts includible in gross income under section 22(k) is deductible under section 23(a)(2). * * *
>
> SEC. 39.24(a)-2. *Capital expenditures.*—(a) *Expenditures except non-depreciable mine development expenditures.*—* * * The cost of defending or perfecting title to property constitutes a part of the costs of the property and is not a deductible expense. * * *

## STATEMENT

The pertinent facts, as found by the Court of Claims (R. 45–61), may be summarized as follows:

Don Gilmore (the taxpayer) and Dixie Gilmore were married in 1946.[1] They had no children. In April, 1952, they separated and Mrs. Gilmore filed suit for divorce in California, charging her husband with extreme cruelty and adultery. (R. 45, 51; Appendix, *infra*, pp. 25, 31.) In June of that year, Mr. Gilmore filed an answer and a cross-complaint for divorce (R. 45; Appendix, *infra*, p. 25), alleging extreme cruelty by Mrs. Gilmore. (R. 51; Appendix, *infra*, p. 31.)

---

[1] Sue Gilmore, a party to this proceeding, is the taxpayer's second wife, whom he married on November 1, 1955. She and the taxpayer filed a joint income tax return in 1955. (R. 45, 58.)

In the divorce proceedings, Mrs. Gilmore made a claim with respect to the taxpayer's principal income-producing property, consisting of holdings in three automobile dealerships which he had acquired prior to his marriage.[2] The stockholdings had increased in value by $600,000 (from $200,000 to $800,000) between 1946 and 1952, and Mrs. Gilmore claimed that this increment was community property under the laws of California. Prior to the divorce trial, she offered to take $275,000 in full settlement of her claim, but the taxpayer rejected the offer because his attorneys advised him that the increment in the value of his holdings was separate property and because he feared that a settlement might result in a cancellation of his dealership franchises. (R. 49–50; Appendix, *infra*, pp. 29–30.)

At the divorce trial, most of the evidence presented by the parties was devoted to the alleged misconduct. Some, though considerably less, testimony, was directed to the question whether the increase in the value of the taxpayer's stock in the automobile deal-

[2] The taxpayer's stockholdings were as follows: 100 percent of the outstanding shares of Don Gilmore-San Francisco; 60 percent of the outstanding shares of Don Gilmore-Riverside; and 73⅓ percent of the outstanding shares of Don Gilmore-Hayward. Each of these was a California corporation which operated as a franchised automobile dealer of a division of the General Motors Corporation. During the taxable years, and for many years previously, the taxpayer was the president and principal managing officer of each of the corporations. He derived substantial income in the form of salaries and dividends from the corporations, largely due to his ownership and control. During 1953 and 1954 his only income from sources unrelated to the corporations was $1,024.90 and $516.60, respectively. He had spent all of his adult life in the retail automobile business and it was the only business he knew (R. 46–48; Appendix, *infra*, pp. 26–28).

erships was community property.[3] After Mrs. Gilmore took the initiative in presenting evidence of misconduct, Mr. Gilmore's attorneys considered it necessary to resist those charges by extensive cross-examination and by evidence of misconduct on Mrs. Gilmore's part. This was undertaken because (1) under California law, the court must award more than 50 percent of the community property, and may award all of it, to the innocent spouse in divorces based on extreme cruelty or adultery; (2) Mrs. Gilmore's charges of misconduct were published in the local newspapers and it was feared that General Motors might cancel the taxpayer's dealership franchises if the allegations were proved; (3) the credibility of the parties became an important factor and the taxpayer's attorneys feared that, if the trial judge believed Mrs. Gilmore's account, he might also find that there was community property and award all or most of it to her; and (4) there was an issue as to whether oral declarations and conduct between the parties had affected the nature of the property in dispute. (R. 51–52; Appendix, *infra*, pp. 31–32.)

In 1953, after trial, the Superior Court found the issues in favor of the taxpayer, granting him an interlocutory divorce, denying Mrs. Gilmore a divorce and holding that there was no community property of the marriage. On October 25, 1955, after an appeal, a remand of the case, and further proceedings in which the Supreme Court of California affirmed the

[3] Other issues were whether Mrs. Gilmore was entitled to alimony and whether two houses in which the parties had lived were held in joint tenancy. Very little time and effort was devoted to these issues by the taxpayer's attorneys. (R. 52; Appendix, *infra*, p. 32.

interlocutory judgment of the Superior Court, a final judgment of divorce in favor of the taxpayer was entered in the trial court.[4] (R. 45; Appendix, *infra*, p. 26.)

As a result of the protracted litigation, the taxpayer was required to pay a total of about $45,911.36 in legal fees for the years 1953, 1954 and 1955 ($32,537.15 for 1953; $8,074.21 for 1954; and approximately $5,300 for 1955). In his income tax returns for 1953 and 1954 (the years here involved), he deducted a substantial portion of the legal fees as an expense incident to defending properties and investments. The Commissioner disallowed the deductions on the ground that the legal fees were personal expenditures and therefore nondeductible under Section 24(a) of the Internal Revenue Code of 1939. The deficiencies were paid and this suit for refund followed. (R. 53–61; Appendix, *infra*, pp. 36–41.)

In the proceedings below, taxpayer claimed, and the Court of Claims held (R. 37–41; Appendix, *infra*, pp. 17–21), that 80 percent of his legal fees were deductible under Section 23(a)(2) of the Internal Revenue Code of 1939 as having been "paid in the conservation of income-producing property." (R. 40; Appendix, *infra*, p. 20.)[5]

## REASONS FOR GRANTING THE WRIT

1. The decision below conflicts in principle with the decision of this Court in *Lykes* v. *United States*, 343 U.S. 118, and is directly opposed to the decision of the

[4] The two residences were held to be joint tenancy property of the parties. (R. 45; Appendix, *infra*, p. 25.)

[5] The remaining 20 percent was allocated to obtaining the divorce, as distinguished from protecting property.

Court of Appeals for the Second Circuit in *Lewis* v. *Commissioner*, 253 F. 2d 821.

The issue in *Lykes*, as here, was the deductibility (as a nonbusiness expense) under Section 23(a)(2) of the Internal Revenue Code of 1939 (*supra*, p. 2)[6] of legal expenses arising out of intra-familial financial matters. Specifically, the question was whether attorneys' fees paid in contesting a gift tax liability were deductible. The deduction was denied on the grounds that Section 24(a)(1) precludes a deduction for "[p]ersonal, living, or family expenses * * *" and that the legal expenses, having their roots in the making of a gift to members of the taxpayer's family, were attributable to a personal or family matter. The Court's holding resulted from the application of principles established in prior cases, *i.e.*, that the source of a liability determines its nature (see *Deputy* v. *duPont*, 308 U.S. 488) and that deductibility depends upon the proximate cause of the expenditure (see *Kornhauser* v. *United States*, 276 U.S. 145). Thus, the Court stated in *Lykes* (343 U.S. at 125): "Legal expenses do not become deductible merely because they are paid for services which relieve a taxpayer of liability. * * * Section 23(a)(2) * * * has been applied to expenses on the basis of their immediate purposes rather than upon the basis of the remote contributions they might make to the conservation of a taxpayer's income-producing assets * * *."

[6] Section 212 of the Internal Revenue Code is also involved here, since it applies to 1954 and subsequent years, but it is similar to Section 23(a)(2) of the 1939 Code.

In the instant case, the legal fees held deductible on the theory that they were expenses "paid in the conservation of income-producing property" (R. 40; Appendix, *infra*, p. 20) are also directly attributable to a personal or family matter—the marital relationship. That relationship was the source of the potential liability which taxpayer resisted in the divorce proceeding. Simply stated, it was marital discord—indisputably, a personal matter—which was the immediate cause of the expenditures for legal services. To be sure, the amount and character of Mrs. Gilmore's claim constituted a serious threat to taxpayer's income-producing property. But as this Court stated in *Lykes* (343 U.S. at 125), neither the size of a claimed liability nor the urgency to resist it determines the character of the legal expenses paid in connection with it; the expenses are nondeductible if they are attributable to a personal matter.

The conflict between the decision below and the basic principles exemplified by *Lykes* is placed in sharp focus by the decision of the Second Circuit in *Lewis* v. *Commissioner*, 253 F. 2d 821. In that case, the taxpayer's wife sued for a legal separation and demanded 50 percent of the stock owned by the taxpayer in a publishing company, as well as 50 percent of various securities which she claimed were held in brokerage accounts in her name and that of the taxpayer jointly. Although a major portion of the services rendered by the taxpayer's counsel related to arrangements for maintenance and support and to the adjustment of the respective property rights of the

parties, the Second Circuit held that none of the legal fees incurred by the taxpayer were deductible.

The conflict has been openly recognized. Thus, the court below stated (R. 38; Appendix, *infra*, p. 18) that there are two lines of authority, one following *Lykes* and the other following *Baer* v. *Commissioner*, 196 F. 2d 646 (C.A. 8th). It concluded that *Baer* represents the correct approach in instances where the scope of the wife's claim is such that "a substantial part of the income-producing property" of the husband is threatened (R. 38–39; Appendix, *infra*, pp. 18–19). But that was also the situation in *Lewis*, in which the court denied all deductions for legal expenses and stated (253 F. 2d at 826–827), "With all deference, we cannot reconcile this decision [*Baer*] with that of the Supreme Court in *Lykes* v. *United States*, *supra*; hence we decline to follow it."

---

Some courts, although not expressly rejecting *Baer*, have denied a deduction for legal expenses incurred in a divorce, separation or maintenance proceeding and distinguished *Baer* on the ground that it involved expenses related not to the question of liability but to the manner in which the liability might be met. See *Smith's Estate* v. *Commissioner*, 208 F. 2d 349, 354 (C.A. 3d); *Harris* v. *United States*, 275 F. 2d 238, 240 (C.A. 9th); *Tressler* v. *Commissioner*, 228 F. 2d 356, 361 (C.A. 9th); *Howard* v. *Commissioner*, 202 F. 2d 28, 30 (C.A. 9th). Two of the circuits which have followed *Baer* have also stressed this distinction. See *Owens* v. *Commissioner*, 273 F. 2d 251, 256 (C.A. 5th); *United States* v. *Patrick*, 288 F. 2d 292, 294–295, 296 (C.A. 4th). The Court of Claims drew a similar distinction in its prior decisions in *McMurtry* v. *United States*, 132 F. Supp. 114, 116, and *Davis* v. *United States*, 287 F. 2d 168 (petition for a writ of certiorari pending on another issue). But even if that distinction were sound, it would not explain the result in the instant case where the principal expense was in resisting liability (successfully, as events proved). Note, also, that in *Lewis* the court disallowed both the expenses involved

2. The question presented by this petition is a recurrent one. In addition to the instant case and *United States* v. *Patrick*, 288 F. 2d 292 (C.A. 4th), in which we are concurrently filing a petition for a writ of certiorari, we know of fourteen cases now pending in the federal courts which involve the issue of deductibility of legal expenses incurred in connection with separation or divorce proceedings.[8] Many such claims are regularly denied administratively. It is of obvious importance, therefore, that the conflict—one which inevitably leads to inequity among taxpayers—be resolved by this Court.

The decision below, moreover, is one which has broad implications. There are numerous situations in which it is necessary to distinguish between conservatory expenses (expenses incurred for the management, conservation or maintenance of property held

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in the determination of the husband's liability and those related to the adjustment of the spouses' property rights. The Tax Court has consistently taken the same view as the *Lewis* decision. *Douglas* v. *Commissioner*, 22 T.C. 349, 355; *Estate of Walsh* v. *Commissioner*, 28 T.C. 1274, 1277; *Joyce* v. *Commissioner*, 3 B.T.A. 393, 397. That result is also required by Treasury Regulations 118, Sec. 39.24(a)-1, *supra*, p. 3.

The decision below is erroneous, we believe, in another respect. Assuming, *arguendo*, that taxpayer's expenses were not personal expenditures within Section 24(a)(1), they were attributable to defense of the wife's claims that the appreciation in the value of the husband's stock was community property. Expenditures in defense of title are capital expenditures and not deductible. *Harris* v. *United States*, *supra*; *Lewis* v. *Commissioner*, *supra*; Treasury Regulations 118, Sec. 39.24(a)-2, *supra*, p. 3.

[8] As indicated in note 7, *supra*, the cases already litigated have resulted in considerable confusion.

for the production of income) and personal expenses which serve to protect financial well-being or to guard against the imposition of liabilities. Consider, for example, expenses incurred in resisting or compromising an action based on a personal tort. If it is enough, as the Court of Claims holds, that a substantial portion of the taxpayer's income-producing property is threatened by a potential adverse judgment, the door is opened wide.

Although we shall not labor the merits in this petition, it is to be observed, as this Court noted in *Lykes* (343 U.S. at 121), that Section 23(a)(2) was enacted to change the result of *Higgins* v. *Commissioner*, 312 U.S. 212, a case which held that an individual taxpayer's expenses in managing his securities were not deductible because they were not incurred in the course of his "trade or business." The legislation reflected a decision by Congress to allow expenditures which had a "business" character, albeit they were not part and parcel of the taxpayer's regular business or profession. But, as emphasized in *Lykes* (p. 122), nothing in the legislation or its history indicates that "Congress sought to make such a change of policy as would authorize widespread deductibility of personal, living or family expenditures in the face of § 24(1)." In our view, the decision of the Court of Claims in the instant case does portend such a "change of policy".

## CONCLUSION

This petition for a writ of certiorari should be granted.

Respectfully submitted.

ARCHIBALD COX,
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MELVA M. GRANEY,
HAROLD C. WILKENFELD,
*Attorneys.*

JULY 1961.

# APPENDIX

# In the United States Court of Claims

No. 374–58

(Decided June 7, 1961)

## DON GILMORE AND SUE GILMORE v. THE UNITED STATES

*Eli Freed* for plaintiffs.

*Benjamin H. Pester*, with whom was *Assistant Attorney General Louis F. Oberdorfer*, for defendant. *James P. Garland* and *Lyle M. Turner* on the brief.

### OPINION

LARAMORE, *Judge*, delivered the opinion of the court:

This is a suit to recover the alleged overpayments of income tax, plus interest accrued, for the taxable years 1953, 1954, and 1955. The defendant counterclaims for the years 1953 and 1954.

Plaintiff[1] is the owner of 100 percent of the shares issued and outstanding of a corporation named Don Gilmore—San Francisco. He is also the owner of 60 percent of the issued and outstanding stock of a second corporation, Don Gilmore—Riverside. In addition, he is the owner of 73⅓ percent of the stock issued and out-standing of a third corporation, Don Gilmore—Hayward. Each of the three named corporations is a franchised dealer of a division of General Motors Corporation. Each of these businesses operated under an annually renewable franchise contract which contained a clause giving the manufacturer the uni-

[1] Sue Gilmore is the present wife of plaintiff. They were married on November 1, 1955. Hereafter, any reference to the term "plaintiffs" in the plural number, pertains to the tax year 1955 only and refers to both Don and Sue Gilmore. The singular "plaintiff" refers solely to Don Gilmore.

lateral right to terminate the franchise on a 90-day notice. The plaintiff is, and for many years has been, the president and principal managing officer of each of the three above-mentioned corporations. He has received the following combined gross salaries from them:

| | |
|---|---|
| 1949 | $79,800.00 |
| 1950 | 61,316.65 |
| 1951 | 66,799.92 |
| 1952 | 66,799.92 |
| 1953 | 66,799.92 |

From his ownership of stock he received as dividends:

| | |
|---|---|
| 1948 | $109,484.80 |
| 1949 | 69,438.23 |
| 1950 | 50,003.48 |
| 1951 | 114,625.65 |
| 1952 | 73,044.00 |
| 1953 (D. Gilmore—San Francisco only) | 39,657.02 |

The only income of plaintiff from sources unrelated to these automobile dealerships for the years in suit was $1,024.90 in 1953, and $516.60 in 1954.

From March 2, 1946 to October 25, 1955, plaintiff was married to one Dixie Gilmore. During all of this time the couple were residents of California. On April 8, 1952, they separated. Two days later, Dixie Gilmore filed for divorce in the Superior Court of the State of California in and for the County of Marin where the parties resided. On June 16, 1952, the plaintiff in the instant case filed an answer to the complaint and a cross-complaint for divorce. This action came to trial, commencing March 16, 1953, and continuing on order until April 24, 1953. The trial court found in favor of Don Gilmore, granting him an interlocutory divorce, denying the divorce to the wife, and decreed that there was no community property of the marriage.

Within the time allowed, Dixie Gilmore appealed this interlocutory judgment to the District Court of Appeals, State of California, First Appellate District. That court, on April 26, 1955, entered its decision reversing the judgment below and ordering a new trial. Thereupon, Don Gilmore petitioned for a hearing of the appeal in the Supreme Court of California. A hearing was granted in the case, and the decision of the District Court of Appeals was vacated by the Supreme Court, and the judgment of the trial court in all

respects affirmed by it on September 23, 1955. After the Supreme Court had affirmed the interlocutory judgment of divorce, a final judgment of divorce in favor of Don Gilmore and against Dixie Gilmore was entered in the trial court on October 25, 1955. As a result of the protracted litigation proceedings, Mr. Gilmore was required to pay legal fees in the amount of $32,537.15 for the year 1953, $8,074.21 for the year 1954, and approximately $5,300 for the year 1955.

The question of community property was an important one during the divorce proceedings. Prior to plaintiff's marriage in 1946, the value of his stockholdings in the three automobile dealerships was approximately $200,000. At the time of their separation, the value of these stockholdings had risen to approximately $800,000. This is an appreciation of $600,000, and it was the contention of Dixie Gilmore that this appreciation was community property. On this basis she contended that she was entitled to one-half the amount, but she was willing to settle for $275,000.

Plaintiff timely filed his individual income tax return for all three years in question. Among other things, plaintiff took a deduction of 80 percent of the cost of the fees involved in the divorce proceedings as an expense incident to the defending of properties and investments. He also claimed deductions in his returns of the full amount of certain State taxes which were due on his full salary. Plaintiff, because he is an employee, had a certain amount of his wages withheld by his employer. In estimating his tax liabilities for 1953 and 1954, plaintiff credited himself with the full amount withheld.

Upon an audit of plaintiff's 1953 and 1954 individual income tax returns the Commissioner of Internal Revenue made a number of disallowances and adjustments, based on the following determinations:

(a) The principal disallowances resulted from the Commissioner's determination that the attorneys' fees, accountant's fee, court reporters' fees, and printing costs, which Don Gilmore paid in 1953 and 1954 in connection with the divorce action, were personal expenditures of Don Gilmore and were not deductible under Section 24(a) of the 1939 Internal Revenue Code.

(b) The Commissioner determined that only $9,762, or one-half of the $19,524 income taxes withheld from Don Gilmore in 1953 should be credited to him, and this resulted in a finding by the Commissioner that $4,881 of the tax liability reported on the 1953 return of Don Gilmore had never been paid.

(c) The Commissioner of Internal Revenue also determined that of the $5,643.10, which Don Gilmore had paid in 1953 for State income and unemployment taxes, Mr. Gilmore was entitled to a credit in his return of only one-half, or $2,821.55, and that the balance was deductible by Dixie Gilmore.

(d) In his 1953 income tax return, Don Gilmore had erroneously reported that of the $66,799.92 of salaries paid to him during that year, the amount of $50,099.92 was taxable to himself individually and the balance of $16,700 was taxable to Dixie Gilmore. The error caused his individual income for the year 1953 to be overstated by the amount of $16,699.96. This error was recognized by the Commissioner of Internal Revenue, who made an adjustment showing that only one-half of the total salaries paid were taxable to Don Gilmore individually.

As a result of various disallowances and adjustments the Commissioner assessed deficiencies in income taxes against plaintiff as follows:

| *Year* | *Tax* | *Interest* | *Total* |
|---|---|---|---|
| 1953 | $18,883.26 | $4,264.25 | $23,147.51 |
| 1954 | 3,762.21 | 583.12 | 4,345.33 |

On November 1, 1955, Don Gilmore and Sue Gilmore were married. When they filed their joint income tax return on April 15, 1956, they claimed a credit for all taxes withheld from Don Gilmore's salary in 1955. In addition they reported as income the total amount of the salary as their joint income. They filed a timely claim for refund of income taxes paid for the year 1955 on the grounds that income received prior to October 25, 1955, was the community property of Don and Dixie Gilmore and that one-half is taxable to Dixie Gilmore.

The defendant in this case asserts a counterclaim against Don Gilmore for the years 1953 and 1954. As a result of the

Commissioner's adjustments concerning the income tax returns of Dixie Gilmore, it was determined that she had a tax balance due of $3,863.78, plus interest for the year 1953. It was similarly determined that she owed $78.93, plus interest, for 1954. A demand for payment was made on Dixie Gilmore on January 7, 1958. Defendant contends that plaintiff, as the husband of Dixie Gilmore, had full and complete control of the community income and is liable for the income taxes of Dixie Gilmore, together with the interest due thereon.

The issues that present themselves are patently discernable from the foregoing sequence of events and we shall direct our answers in the order that the questions appear.

This court has recently had occasion to review the question of deductibility of legal expenses incurred in divorce litigation. *Davis v. United States*, No. 516-58, decided March 1, 1961. In that case the plaintiff attempted to deduct two types of legal fees paid by him: first, legal fees paid for tax advice, and second, legal fees incurred in connection with the protection of income-producing property. This court allowed the deduction as to the first type of legal fees, but denied the deduction as to the second type. In the instant case we are concerned with deductions of the second type; *i.e.*, expenses incurred in connection with the protection of income-producing property.

The general rule is that attorneys' fees paid in connection with a divorce are not deductible. Therefore, in order to bring himself under the section permitting the deduction, plaintiff must show that the legal expenses were incurred in matters directly related to his business or the management, conservation, or maintenance of property held for the production of income. *Port v. United States*, 143 Ct. Cl. 334.

Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939, provide:

> § 39.24(a)-1 *Personal and family expenses.* * * * Generally, attorneys' fees paid in a suit for divorce or separate maintenance are not deductible. However, the part of an attorney's fee paid in a divorce or separate maintenance proceeding which is properly attributable to the production or collection of amounts includible in gross income under section 22(k) is deductible under section 23(a)(2). * * *.

In *Davis* v. *United States*, *supra*, we discussed the pertinent cases in this area of the law. We pointed out that there were two groups of cases followed by the courts. One class of authority follows the decision in *Lykes* v. *United States*, 343 U.S. 118, and the other class follows the decision in *Baer* v. *Commissioner*, 196 F. 2d 646. We indicated a belief that it was not necessary to choose which decision is right in the premises because of factual differences in the two lines of cases. We are still of this opinion. However, the facts in the instant case clearly come under the rule laid down by the court in the latter line of cases. At the time of commencement of the divorce proceedings, plaintiff was 62 years of age; he had spent all his adult life in the retail automobile business; he would not have been able to gain employment in some other business, neither could he obtain employment as president or general manager of an automobile dealership, except through a controlling stock ownership interest. The evidence is clear that the large salary paid to plaintiff was not in return for his services rendered, but because he was the controlling stockholder. It is not too difficult to imagine that an irate ex-wife, if she gained control of a corporation, would dispose of her ex-husband as president. Thus, plaintiff was fighting not only to protect his income-producing property, but to prevent the loss of his salary as well.

In addition to the possible loss of his income, and the possible loss of 50 percent or more of the appreciation in the value of the stock, plaintiff could have lost his franchise with the General Motors Corporation through a proviso in the contract permitting a termination in the event of:

> Any sale, transfer, relinquishment, voluntary or involuntary, by operation of law or otherwise, of any interest in the direct or indirect ownership or active management of dealership without the prior written approval of Seller.

The sensational nature of the divorce charges of adultery and misconduct, brought by Dixie Gilmore, were published in the local papers. This adverse publicity created a real fear that General Motors might terminate the franchise if the allegations were established and a divorce granted to the wife. Even though Dixie Gilmore took the initiative in raising charges of misconduct, the plaintiff resisted these

charges and brought charges of his own. He did this not because he opposed the idea of his wife obtaining a divorce, as evidenced by the fact that six days after the divorce became final he married again, but because of the consequences that would result from a determination that the charges brought against him were well founded. It is important to notice that under California law, the court must award *more* than 50 percent of the community property, and may award *all* of the community property to the innocent spouse in divorces based on extreme cruelty or adultery. There can be little doubt that Dixie Gilmore sought more than a divorce. If that was all she wanted, she received it at the trial level, but this divorce action went all the way to the Supreme Court of California. Dixie Gilmore wanted a substantial part of the income-producing property of plaintiff.

The Internal Revenue Code of 1939, 26 U.S.C. (1946 Ed.), which was in effect at that time, states:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> (a) Expenses.
>
> * * * * * *
>
> (2) Non-trade or non-business expenses.
>
> In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

Of course it is true that in every divorce case a certain amount of the legal expenses are incurred for the purpose of obtaining the divorce and a certain amount are incurred in an effort to conserve the estate and are not necessarily deductible under section 23(a)(2), but when the facts of a particular case clearly indicate that the property, around which the controversy evolves, is held for the production of income and without this property the litigant might be denied not only the property itself but the means of earning a livelihood, then it must come under the provisions of section 23(a)(2), *supra*. The only question then is the allocation of the expenses to this phase of the proceedings. Here, the plaintiff claims that 80 percent of the legal ex-

penses were incurred in the conservation of his income-producing property. The commissioner of this court found that at least 80 percent of the legal expenses were so incurred and this is supported by the evidence. The defendant contends that it is the burden of the taxpayer to establish the exact amount to which he is entitled and, if he cannot meet this requirement, then the deduction must be denied. In considering this contention our attention immediately focuses on the landmark case of *Cohan* v. *Commissioner*, 39 F. 2d 540, where Judge Learned Hand directed the court to this question, at page 543:

> * * * The Board refused to allow him any part of this, on the ground that it was impossible to tell how much he had in fact spent, in the absence of any items or details. The question is how far this refusal is justified, in view of the finding that he had spent much and that the sums were allowable expenses. Absolute certainty in such matters is usually impossible and is not necessary; the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making. * * *.

This decision has proved a valuable and workable rule over the years and has withstood the attacks made upon it by the Internal Revenue Service. We are not prepared to sanction an outright frontal attack upon this rule.

We are of the opinion that the evidence presented by the plaintiff is sufficient to support a finding that 80 percent of the legal expenses incurred in this instance were paid in the conservation of income-producing property. Also, we can find no merit in defendant's further contention that the expenses were actually incurred in defense or perfection of title of a capital asset. The stocks in question belonged to plaintiff before he was married and the wife never suggested that he did not hold perfect title to them. In fact, to do so would have defeated her purpose because if he did not have perfect title in the stocks she could not have asserted an interest in the appreciation thereon. Under these circumstances there can be no question that plaintiff has perfect right to the stocks.

Therefore, following the same rationale as in the *Davis* case, *supra*, we reach a contrary conclusion. The facts in

the instant case indicate a situation similar to the facts in *McMurtry* v. *United States*, 132 Ct. Cl. 418; *Baer* v. *Commissioner*, *supra*; *Bowers* v. *Commissioner*, 243 F. 2d 904; and *Fisher* v. *United States*, 157 F. Supp. 364.

We turn next to the question whether the defendant was correct in crediting plaintiff with only one-half of the state taxes paid by him, and one-half of the Federal taxes withheld from his salary for the years 1953 and 1954.

Section 35 of the 1939 Internal Revenue Code provides:

> § 35. *Credit for tax withheld on wages.*
>
> The amount deducted and withheld as tax under Subchapter D of Chapter 9 during any calendar year upon the wages of any individual shall be allowed as a credit to the recipient of the income against the tax imposed by this chapter for the taxable year beginning in such calendar year. * * *

The Regulations then define who the recipient of the income is:

> § 39.35–1. *Credit for tax withheld on wages.*
>
> * * * For the purpose of the credit, the recipient of the income is the person subject to tax imposed under chapter 1 upon the wages from which the tax was withheld. For instance, if a husband and wife domiciled in a State recognized as a community property State for Federal tax purposes make separate returns, each reporting for income tax purposes one-half of the wages received by the husband, each spouse is entitled to one-half of the credit allowable for the tax withheld at source with respect to such wages.

The authority in California is clear that the earnings of the husband continue to be community income until the final judgment of divorce. *Waters* v. *Waters*, 170 P. 2d 494. The amounts of these salaries were community income owned equally by Don Gilmore and Dixie Gilmore and one half of such community income was taxable to Don Gilmore and the other one-half to Dixie Gilmore. In filing his income tax returns for the years 1953 and 1954, the plaintiff arbitrarily attributed a high percentage of the income to himself and a low percentage to his wife. The only way we know that the whole of something may be divided equally into two parts is by dividing it in half. Therefore, we are of

the opinion that the defendant was correct in adjusting plaintiff's tax return to reflect this amount of income. This necessarily brings us to the question of what amount of deductions should be allowed to plaintiff considering that only half of the total salaries was taxable to plaintiff individually. We sustain the Government on the issue pertaining to the amount withheld from the salaries. It is apparent that if the salaries are community property, to be divided 50–50, any amount withheld to pay an obligation of both should be considered to have been withheld from each. This is consistent with Treasury Regulation 118, § 39.35–1, and it appears to be a fair and equitable solution to the problem.

On the other hand, the answer to the question of which party is entitled to the deduction for California personal income and unemployment taxes is quite different. The general rule is that a taxpayer cannot deduct taxes "paid or accrued" unless he is legally liable to the authority imposing the tax. The applicable California statute provides:

> § 18555. *Liability of spouses; community income; joint returns.*
>
> The spouse who controls the disposition of or who receives or spends community income as well as the spouse who is taxable on such income is liable for the payment of the taxes imposed by this part of such income. * * *. [California Revenue and Taxation Code (61 West's Ann. Calif. Codes)]

We think this statute establishes the liability of the plaintiff for the state tax responsibilities of his wife. Since plaintiff paid the taxes he is entitled to the deduction. In the case of *Al Jolson*, 3 T.C. 1184, the husband was entitled to deduct the wife's state income taxes which he paid because he was personally liable under the state law.

After these adjustments are made there will remain a tax deficiency on the part of Dixie Gilmore for the years 1953 and 1954. The defendant counterclaims for the amounts of these deficiencies on the basis that they are taxes incurred upon the community income of Don and Dixie Gilmore. We agree that the salaries paid plaintiff during this period were community property, but it does not follow that plaintiff is liable for the tax deficiencies of his wife. In our search of the authorities we have been able to find only two unreported

cases that stand for the proposition that the community property is 100 percent liable for the tax liabilities of one of the parties when they had filed separate returns. *G. J. Rodgers*, 51-2 USTC, ¶9495; *R. F. Ryan*, 51-2 USTC, ¶9493. The weight of authority is to the contrary. In *Marjorie Hunt*, 22 T.C. 228, the Tax Court stated at page 230:

> * * * For purposes of Federal income taxation, each spouse is equally liable for payment of the tax on his or her respective equal share of the community income. *United States* v. *Malcolm*, 282 U.S. 792 (1931); *Poe* v. *Seaborn*, 282 U.S. 101 (1930). This liability is fixed and definite. It is not a means of splitting income which may be voluntarily chosen or elected to minimize taxes. * * * Her liability for tax ceases only when her interest in the community income ceases. * * *

Again, in *Harrold*, 22 T.C. 625, the court in referring to the two unreported cases mentioned previously stated at page 628:

> * * * It is contrary to a line of cases in which we, and other courts, have held that the powers of management conferred upon the husband by community property laws do not render him personally liable for taxes on his wife's share of the community income. *Poe* v. *Seaborn*, 282 U.S. 101 (1930); *Paul Cavanagh*, 42 B.T.A. 1037 (1940), affirmed on another issue, 125 F. 2d 366 (C.A. 9, 1942); * * * The following explanation given by this tribunal in the *Cavanagh* case, pages 1043 and 1044, adequately answers petitioner's contention:
>
> > "The fact that under the California law the husband has a broad power of control does not detract from the wife's interest. This power is conferred upon him merely as the agent of the community and does not make him the owner of all the community property and income, nor negative the wife's present interest there as equal coowner. * * *.

Although the *Harrold* case, *supra*, was reversed on factual grounds in *Harrold* v. *Commissioner*, 232 F. 2d 527 (C.A. 9th), the question whether an overpayment refundable to the husband was to be charged with taxes due from the wife was not considered by the Court of Appeals. The whole concept of community property is a legal fiction. It is no more fictitious to say that the wife earned half the husband's salary by housekeeping than it is to say that each earned half the total income through their own efforts. Once the

law accepts the concept of two individuals each owning an equal half of the income and each individual files a separate return that is the end of it. Each party must be treated as an individual, as if they were not husband and wife. In *Harrold*, *supra*, the court in attempting to clarify this area of the law emphatically stated at page 629:

> * * * We subsequently emphasized in *H. B. Perine et al.*, *supra*, that we could not require the respondent to do so, stating in part:
>
> > The spouses became separate and distinct taxpayers under the statute upon the filing of separate returns of the community income, and the situation is no different than it would be if the taxpayers were other than husband and wife. They being separate taxpayers, we lack authority to require the respondent to credit the proposed deficiency determined against the wife with an overpayment of tax by the husband. *Alexander Vaysse*, 8 B.T.A. 587. Cf. *John W. Preston*, 21 B.T.A. 840.

The defendant cites *Clayton* v. *United States*, 70 Ct. Cl. 740, cert. denied, 283 U.S. 860, and *Lattimore et al.* v. *United States*, 82 Ct. Cl. 97, as supporting the allocation of an overpayment by one spouse to a deficiency of the other. However, in each of those cases the taxpayers originally filed a joint return, indicating that the amount paid with the joint return was intended to be applied to the tax liabilities of each. The defendant also relies on another decision of this court, *Santos* v. *United States*, No. 433-58, decided May 4, 1960, 277 F. 2d 806. The obvious distinction is in that case the law applicable was the Hawaiian Code which made the community property liable, not the California Code, and as the defendant points out in its brief:

> Legal rights, liabilities and interests of husband and wife are created by state law, and the Federal revenue laws determine how the interests and liabilities as created shall be subject to income taxes. *Trapp* v. *United States*, 177 F. 2d 1 (C.A. 10th).

As a consequence of the above-stated reasons, we find that the defendant is not entitled to recover on its counterclaim.

This brings us to the last issue concerning plaintiff's liability for 1955. The Government concedes that the salaries of plaintiff from January 1, 1955 to October 25, 1955,

were community income to him and Dixie Gilmore at the time the divorce became final. Therefore, plaintiffs were required to include only one-half the income received during this period in their 1955 joint tax return. It should be mentioned in passing that the tax return of Dixie Gilmore for 1955 does not indicate a tax deficiency; in fact, there is an overassessment of $1,895.76, which the defendant might apply against Dixie Gilmore's tax deficiencies for 1953 and 1954.

It is so ordered.

DURFEE, *Judge*; MADDEN, *Judge*; WHITAKER, *Judge*; and JONES, *Chief Judge*, concur.

FINDINGS OF FACT

The court, having considered the evidence, the report of Trial Commissioner Wilson Cowen, and the briefs and argument of counsel, makes findings of fact as follows:

1. Plaintiffs are and since November 1, 1955, have been husband and wife. They are citizens and residents of California.

2. From March 2, 1946 to October 25, 1955, plaintiff Don Gilmore was married to one Dixie Gilmore. During all of their marriage, Don Gilmore and Dixie Gilmore were residents of California.

3. On April 8, 1952, Don Gilmore and Dixie Gilmore were separated after six years, one month and six days of childless marriage. On April 10, 1952, Dixie Gilmore filed a complaint for divorce against Don Gilmore in the Superior Court of the State of California in and for the County of Marin, where the parties resided. On June 16, 1952, Don Gilmore filed an answer to this complaint and a cross-complaint for divorce against Dixie Gilmore. This action came to trial in due course in the Superior Court, commencing March 16, 1953, and continuing in order until April 24, 1953. The trial court found the issues in favor of Don Gilmore, denied Dixie Gilmore a divorce from Don Gilmore, and granted Don Gilmore an interlocutory judgment of divorce from Dixie Gilmore, wherein it decreed that there was no community property of the marriage, adjudged two residences to be joint tenancy property of the parties, and determined contrary to her claims that Dixie Gilmore had no community

interest in certain property, more specifically described hereafter, which stood of record as the separate property of Don Gilmore.

4. Dixie Gilmore appealed from this interlocutory judgment to the District Court of Appeal, State of California, First Appellate District. That court on April 26, 1955, entered its decision reversing the judgment below and ordering a new trial. Thereupon respondent Don Gilmore petitioned for a hearing of the appeal in the Supreme Court of the State of California. A hearing was granted in the case, and the decision of the District Court of Appeal was vacated by the Supreme Court, and the judgment of the trial court in all respects affirmed by it on September 23, 1955. The decision of the Supreme Court is reported at 45 Cal. 2d 142.

5. After the Supreme Court of California had affirmed the interlocutory judgment of divorce, a final judgment of divorce in favor of Don Gilmore and against Dixie Gilmore was entered in the Superior Court of the State of California in and for the County of Marin on October 25, 1955.

6. In his divorce litigation with Dixie Gilmore plaintiff Don Gilmore was represented at all times by Michael L. Haun, Esquire, of the California bar, and from the outset of the litigation until about March 13, 1953, also by Walter F. Freitas, Esquire, of the law firm of Freitas, Freitas & Allen. From January or February 1953, until the conclusion of this litigation, plaintiff Don Gilmore was also represented therein by Wallace S. Myers, Esquire, of the law firm of Myers & Meehan. Dixie Gilmore's attorneys in said litigation from its inception until August 18, 1953, were Leslie C. Gillen, Esquire, and Charles A. Christin, Esquire. After that date and until the end of the litigation, her attorneys were James Martin MacInnis, Esquire, and Nicholas Alaga, Esquire.

7. When Dixie Gilmore commenced her action for a divorce against plaintiff Don Gilmore on April 10, 1952, and when that action was tried, Don Gilmore individually was the record owner of the following securities:

(a) 3,000 shares of the common stock of Don Gilmore—San Francisco, a California corporation, being 100 percent of the issued and outstanding stock of said corporation;

(b) 1,500 shares of the common stock of Don Gilmore—Riverside, a California corporation, being 60 percent of the issued and outstanding stock of said corporation. The remaining shares of stock of this corporation were then owned by Thomas E. Brady and H. J. McCullough.

(c) 1,833⅓ shares of the common stock of Don Gilmore—Hayward, a California corporation, being 73⅓ percent of the issued and outstanding stock of said corporation. The remaining shares of stock of this corporation were then owned by C. N. Wilson and H. J. McCullough.

All of his stock interests in these corporations had been owned by Don Gilmore continuously since a date prior to his marriage to Dixie Gilmore.

8. For many years prior to the divorce litigation and during that litigation, Don Gilmore—San Francisco (a corporation), was engaged in the business of operating a franchised Chevrolet dealership for the retail sale and servicing of new and used automobiles and trucks in San Francisco, California. During the same period, Don Gilmore—Riverside (a corporation), carried on a like business as a franchised Pontiac dealership in Riverside, California, and Don Gilmore—Hayward (a corporation), carried on a like business as a franchised Chevrolet dealership in Hayward, California. Each of these businesses operated under an annually renewable franchise contract with a division of General Motors Corporation; each franchise contract contained a clause giving the manufacturer the unilateral right to terminate the franchise on 90 days' notice.

9. For many years prior to the trial of the divorce action between Dixie Gilmore and himself, plaintiff Don Gilmore had been the president and principal managing officer of each of the three above-mentioned corporations. He had received the following combined gross salaries from them:

| | |
|---|---|
| 1949 | $79,800.00 |
| 1950 | 61,316.65 |
| 1951 | 66,799.92 |
| 1952 | 66,799.92 |

10. In 1953, the year in which the divorce action was tried, Mr. Gilmore received salaries as president of the three corporations in the total combined amount of $66,799.92, broken down as follows:

| | |
|---|---|
| San Francisco | $49,999.92 |
| Hayward | 10,800.00 |
| Riverside | 6,000.00 |

**11.** From his ownership of stock in the foregoing corporations Don Gilmore had received the following dividends in recent years prior to 1953:

| | |
|---|---|
| 1948 | $109,484.80 |
| 1949 | 69,438.23 |
| 1950 | 50,663.48 |
| 1951 | 114,625.65 |
| 1952 | 73,044.00 |

In 1953 Don Gilmore received a dividend from Don Gilmore—San Francisco, in the amount of $39,657.02.

**12.** The only income of Don Gilmore from sources unrelated to these automobile dealerships for the years in suit was $1,024.90 in 1953, and $516.60 in 1954.

**13.** The salaries paid to Don Gilmore by the three automobile dealerships, and particularly the large portion thereof paid to him by Don Gilmore—San Francisco, were generous for the services he performed. He was paid these salaries only because of his controlling stock ownerships in these corporations. His salaries for corresponding positions would have to be greatly reduced if he were employed by corporations which he did not own outright or control.

**14.** Don Gilmore had spent all of his adult life in the retail automobile business. This was the only business he knew. In 1952 and 1953, he was 62 years of age, and too old to get another job as president or general manager of an automobile dealership, except through a controlling stock ownership interest.

**15.** Among the provisions of the automobile dealerships' franchise contracts was a Minimum Capital Standard Agreement, by which the manufacturer required each dealership to maintain a stated minimum of total owned capital. In the case of Don Gilmore—San Francisco, the total owned capital required by the Chevrolet Division of General Motors Corporation for the year commencing November 1, 1954, was $556,283. As of July 31, 1954, the total owned capital of that corporation was $626,486, all of which was owned by Don Gilmore individually.

**16.** The franchise contracts also provided that the General Motors Corporation could immediately terminate the fran-

chises by delivering to the dealer or his representative a written notice of termination in the event of:

> Any sale, transfer, relinquishment, voluntary or involuntary, by operation of law or otherwise, of any interest in the direct or indirect ownership or active management of dealership without the prior written approval of Seller.

**17.** Shortly after Don and Dixie Gilmore first separated about April 8, 1952, Mr. Haun, Mr. Gilmore's attorney, had one or two discussions with Mrs. Gilmore's attorney in an effort to determine whether there was a possibility of saving the marriage. However, it was soon evident that there was no possibility of a reconciliation, and no further efforts to save the marriage were made after April 15, 1952.

**18.** In May 1952, Don Gilmore had accepted the fact that his marriage to Dixie was beyond repair. He was willing to have a divorce granted to Dixie and to pay her a reasonable amount of alimony for a reasonable period. In principle, Dixie's demands that she should obtain the divorce and that she should receive an appropriate amount of alimony were acceptable to Don Gilmore and to his counsel.

**19.** At the time of his marriage to Dixie Gilmore in 1946, the value of Don Gilmore's stockholdings in the three automobile dealerships was approximately $200,000. At the time of their separation, the total value of these stockholdings had risen to approximately $800,000.

In 1952 and prior to the trial of the divorce suit, Michael Haun and, subsequently, Walter F. Freitas, as attorneys for Don Gilmore, had conferences with Messrs. Gillen and Christin, who represented Dixie Gilmore, in an effort to settle the litigation. In each of these conferences, Dixie's attorneys took the position that the increase of approximately $600,000 in the value of Don Gilmore's stockholdings was money earned by virtue of his personal services to the corporations and, therefore, was community property under the laws of California. On this basis, they contended that Dixie Gilmore was entitled to one-half of the value of the increase but stated that if Don Gilmore would pay Dixie Gilmore $275,000 in cash, she would accept that in full settlement of her claim.

During the divorce trial, Dixie Gilmore sought to recover $300,000 as her community share of the $600,000 increase in the value of the stock.

20. Don Gilmore rejected Dixie Gilmore's demands for a settlement payment of $275,000 for the following reasons:

(a) It would have been impossible for him to raise $275,000 in cash without selling a substantial portion of his stocks in the automobile dealerships. In the event of the sale of sufficient stock to raise that amount, his capital investment in the dealerships would have been reduced below the minimum capital standards required in his dealer franchise contracts, and he feared that such a reduction would result in the cancellation of the franchises.

(b) Although Dixie Gilmore's attorneys stated that she would accept stock in lieu of cash in payment of the settlement, Don Gilmore feared that the General Motors Corporation would not accept Dixie Gilmore as a shareholder in the corporations and would cancel the franchise contracts pursuant to the contract provision quoted in finding 16.

(c) His attorneys advised Don Gilmore that any increase in the value of the separate property of a spouse as a result of his personal efforts or services during marriage was recognized by California law as community property, but that any increase in value of the stocks due to a return on the investment remained separate property. After examining his books and records, his attorneys further advised him that they had determined that during the marriage he had drawn salaries from the corporations in amounts which the attorneys felt were the maximum salaries that the Internal Revenue Service would recognize as reasonable compensation for managing officers of automobile dealerships and that all of the proceeds of the salaries had been spent by Don Gilmore and Dixie during their marriage. Accordingly, they advised him that any additional increment of value accruing to his shares of stock in the dealerships during the marriage was his separate property and not community property.

21. After the efforts to settle failed, the action went to trial in the Superior Court. The trial consumed a period of 24 days, and the reporter's transcript of the case consisted of 11 volumes containing 3,063 pages.

22. With respect to the issues before him, the trial judge made the following statement:

> The primary issue here, aside from the divorce itself, is the question of the evaluation and determination of the defendant's separate or community property first, most noteworthy the claim set forth by Mr. Gilmore and his counsel that the increase, balance sheet increase, the increase in net worth, that is, overall net worth of his interest in the agencies represented by his holdings.

23. The issue as to which party was entitled to be granted the divorce arose out of allegations by Dixie Gilmore that Don Gilmore was guilty of extreme cruelty and adultery and by the allegation of his cross-complaint that she had been guilty of a continuous course of misconduct that constituted extreme cruelty. The evidence, including the transcript of the evidence at the divorce trial, reflects that the major portion of the evidence presented by both parties and the time required for its presentation were devoted to the misconduct charges. A considerably smaller portion of the evidence related to the question of whether the increase in the value of Don Gilmore's stock was community property.

However, after Dixie Gilmore took the initiative in raising charges of misconduct on the part of Don Gilmore, his attorneys determined that it was necessary to resist these charges by extensive cross examination of Dixie Gilmore, by rebuttal evidence, and by evidence of misconduct on the part of Dixie Gilmore, for the following reasons:

(a) Under California law, the court must award more than 50 percent of the community property, and may award all of the community property to the innocent spouse in divorces based on extreme cruelty or adultery, the grounds alleged by Dixie Gilmore.

(b) The credibility of the parties became an important factor in the evaluation by the trial court of the entire case, including both the misconduct and community property issues. Don Gilmore's attorneys feared that if the trial judge believed Dixie's charges, he might also find that there was community property and award all or most of it to her.

(c) There was an issue as to whether oral declarations and conduct between the parties had affected the nature of the property in dispute.

(d) Dixie Gilmore's charges of misconduct by Don Gilmore were published in the local newspapers. As a result, Don Gilmore feared that if the allegations were established and a divorce based on such charges was granted to Dixie Gilmore, the General Motors Corporation might cancel his dealership franchises. Although the evidence does not show whether or not his fears were justified, he and his attorneys felt it necessary to refute Dixie Gilmore's accusations and to prove misconduct on her part.

24. In preparation for and during the trial of the divorce suit, Don Gilmore's attorneys devoted considerable effort in establishing that no portion of the increase in the value of his stock constituted community property. The most important evidence presented by Mr. Gilmore's attorneys on the community property issue consisted of (a) proof that the salaries paid him by the corporations in which he owned stock represented more than ample compensation for the services he rendered as an officer of these corporations, and (b) proof presented through a certified public accountant that the community obligations and expenses that had been paid during the marriage exceeded the salaries and other community income that Don Gilmore had earned during the marriage.

25. In addition to the principal issues described above, the questions of whether Dixie Gilmore was entitled to alimony and whether two houses in which the parties had lived were held in joint tenancy were also before the court in the divorce action. Before the trial began, Don Gilmore's attorneys anticipated that the court would direct the payment of alimony to Dixie Gilmore for a period of two or three years, since that had been the usual practice of many of the Superior Court judges in divorce actions where the marriages were of short duration. The evidence shows that little time and effort were devoted by Don Gilmore's attorneys on the alimony issue. Although there was a question as to whether two residences in which the parties had lived were held in joint tenancy, very little evidence was required to dispose of the matter, because the deeds to the properties were admitted in evidence and showed, as the court held, that the houses were in fact held in joint tenancy by Don and Dixie Gilmore.

26. As shown by the decision of the California Supreme Court in *Gilmore* v. *Gilmore*, 287 P. 2d 769, there were two methods which had been used by the California courts in making an allocation between community and separate property. One method (the one urged by Dixie Gilmore's attorneys) for determining what part of an increase in the value of a business is community property is to subtract from the total increase a reasonable return on the value at the time of the marriage and treat the remainder as community property.

The other method—advocated by Don Gilmore's attorneys and adopted by the trial court—is to deduct from the total earnings of the business the value of the husband's services to it. The remainder, if any, represents the earnings attributable to the separate property invested in the business. The trial court's decision in this respect was affirmed by the California Supreme Court on the basis of the trial court's findings that Don Gilmore's corporations were staffed by well trained personnel who were capable of carrying on the businesses unassisted; that he worked relatively short hours and took many extended vacations; that the salaries he received, constituting community income, were more than ample compensation for the services he rendered, and that during the period involved there was a tremendous increase in the automobile business that was accompanied by an increase in the value of dealer franchises.

27. After Dixie Gilmore appealed from the interlocutory decree rendered by the Superior Court, it was necessary for Michael L. Haun and Wallace S. Myers, as Don Gilmore's attorneys, to spend considerable effort, research, thought, and planning on the appellate proceedings and to write briefs and make arguments before the appellate courts during 1953, 1954, and 1955. A reversal of the trial court's decision or the granting of a new trial would have deprived their client of the success achieved at the trial.

28. During 1953 and 1954, Don Gilmore paid the following amounts for work or services rendered by his attorneys and others in connection with the divorce litigation:

*1953*

| | |
|---|---|
| Michael L. Haun, attorney | $8,281.50 |
| Walter F. Freitas, attorney | 3,500.00 |
| Wallace S. Myers, attorney | 14,265.00 |
| R. L. Schwerin, C.P.A. | 1,500.00 |
| Court reporters | 4,990.65 |
| Total | 32,537.15 |

*1954*

| | |
|---|---|
| Michael L. Haun, attorney | $5,250.00 |
| Wallace S. Myers, attorney | 2,000.00 |
| Pernau-Walsh Printing Co. (briefs on appeal) | 804.21 |
| Court reporter | 20.00 |
| Total | 8,074.21 |

(a) When Dixie Gilmore appealed from the interlocutory judgment, Don Gilmore was ordered by the trial court to pay for a transcript of the trial proceedings and paid the $4,990.65 listed above to two court reporters for their preparation of the transcript.

(b) In connection with the trial of the divorce action, Don Gilmore's attorneys retained on their client's behalf Robert Schwerin, a certified public accountant, who made an examination of Don Gilmore's books and prepared accounting schedules showing that the community expenses of Don and Dixie Gilmore during their marriage were greater than his salaries and other community income during the same period. The schedules were admitted in evidence in connection with Mr. Schwerin's testimony in the divorce suit. He was paid a fee of $1,500 for the services he rendered for Don Gilmore.

(c) Walter F. Freitas is an attorney who represented Don Gilmore after the divorce suit was filed, but he withdrew from the case shortly before it went to trial. He represented Mr. Gilmore in the negotiations for settlement and in the taking of depositions before the trial itself began. Don Gilmore paid him $3,500 for the legal services he rendered in this connection in 1953.

(d) Michael L. Haun served as Mr. Gilmore's attorney from date of the filing of the divorce action until the final judgment was entered after the decision of the California Supreme Court on appeal.

(e) Wallace S. Myers, an attorney, was employed by Mr. Gilmore to represent him about February 1953, after the

divorce suit was filed, and he continued with Mr. Haun to represent Mr. Gilmore thereafter throughout the trial and appeal of the case until final judgment was entered.

(f) As indicated in the foregoing table, the sum of $804.21 was paid by Don Gilmore in 1954 to the Pernau-Walsh Printing Co. for printing briefs on the appeals from the interlocutory decree of divorce.

(g) Don Gilmore also paid $20 to a court reporter for services rendered in connection with the divorce litigation in 1954.

29. None of the three attorneys who represented Don Gilmore kept records in which he undertook to allocate what percentage of his time or efforts was devoted to each of the several issues involved in the divorce litigation. However, each of them testified that more than 80 percent of the legal services which they rendered and for which they were paid by Don Gilmore in 1953 and 1954 were directed toward preserving his stock in the three dealerships as his separate property and in defeating Dixie Gilmore's claim that she was entitled to one-half of the increment in the value of that stock that occurred during the marriage. The attorney who represented Dixie Gilmore in the appeals testified that he was unable to determine the percentage of effort that the attorneys for either side devoted to the several issues, because the factual issues regarding misconduct and community property merged and overlapped in view of the fact that the California law requires the court to award more than 50 percent of the community property to the innocent spouse in cases where a divorce decree is awarded on grounds of adultery or extreme cruelty.

If Dixie Gilmore had succeeded in obtaining the community interest she claimed in the stock of the automobile corporations and the dealership contracts held by Don Gilmore had been canceled because of his failure to maintain the minimum ownership of capital required by such contracts, he would have lost his positions and salaries as an officer of the corporations and, as stated in finding 14, he was too old at the time to get a similar position with other automobile dealers.

30. The evidence, particularly the facts set forth in finding 23, establishes that 80 percent or more of the amounts which

Don Gilmore paid to his attorneys and his accountant in 1953 and to his attorneys in 1954 were for services rendered by them to defeat Dixie Gilmore's claims to one-half of the value of the increase of his stock in the three dealership corporations, and to establish that no portion of such stock was community property.

**31.** (a) Don Gilmore timely filed his individual income tax return for the calendar year 1953 with the District Director of Internal Revenue at San Francisco. Mr. Gilmore reported a total tax liability of $18,209.86 and further reported that of this sum, $14,643 had been paid as income taxes withheld from his salaries by his employers and by excess F.I.C.A. tax payments. By this computation, there was a balance due of $3,566.86, which he paid with his return.

(b) His 1953 tax return reflected the following allocations of salaries received and taxes withheld:

| INCOME: | | | |
|---|---|---|---|
| *Salaries:* | *Total* | *Don Gilmore* | *Dixie Gilmore* |
| Don Gilmore, San Francisco | $49,999.92 | | |
| Don Gilmore, Hayward | 10,800.00 | | |
| Don Gilmore, Riverside | 6,000.00 | | |
| | 66,799.92 | $50,099.92 | $16,700.00 |
| Parties divorced. | | | |
| Community status through 7-1-53. | | | |
| *Allocation of Withholding Tax:* | | | |
| Don Gilmore, San Francisco | $15,000.00 | | |
| Don Gilmore, Hayward | 3,240.00 | | |
| Don Gilmore, Riverside | 1,176.00 | | |
| Excess F.I.C.A. Tax | 108.00 | | |
| | 19,524.00 | 14,643.00 | 4,881.00 |

(c) Among others, Don Gilmore took a deduction in his 1953 income tax return in the sum of $31,377.20 for "Costs of defending properties & investments. Legal fees and accounting costs".

(d) In his 1953 tax return, Mr. Gilmore also claimed deductions for the following taxes which he allocated as follows:

| | *Total* | *Don Gilmore* | *Dixie Gilmore* |
|---|---|---|---|
| California income taxes | $5,643.10 | $4,691.22 | $951.88 |
| Unemployment tax | 30.00 | 22.50 | 7.50 |

32. (a) Don Gilmore timely filed his individual income tax return for the calendar year 1954 with the District Director of Internal Revenue at San Francisco, reporting a tax liability of $7,098.71, taxes withheld of $11,879.67, and an overpayment of income taxes for the year in the sum of $4,781.84.

(b) Among the deductions claimed in his 1954 return, was one in the sum of $6,499.37 for "Costs of defending properties and investments—legal fees".

(c) In the same return he also reported the payment and allocation of the following State income and unemployment taxes:

| *Taxes:* | *Total* | *Don Gilmore* | *Dixie Gilmore* |
|---|---|---|---|
| State Income Tax | $1,492.84 | $1,492.84 | |
| State Income Tax additional—1950–51 | 982.11 | 491.06 | $491.05 |
| Unemployment tax | 30.00 | 15.00 | 15.00 |

33. Upon an audit of Don Gilmore's 1953 and 1954 individual income tax returns, the Commissioner of Internal Revenue made a number of disallowances and adjustments, including the following:

(a) The principal disallowances resulted from the Commissioner's determination that the attorneys' fees, accountant's fee, court reporters' fees, and printing costs, which Don Gilmore paid in 1953 and 1954 in connection with the divorce action, were personal expenditures of Don Gilmore and were not deductible under Section 24(a) of the 1939 Internal Revenue Code.

(b) The Commissioner determined that only $9,762, or one-half of the $19,524 income taxes withheld from Don Gilmore in 1953 should be credited to him, and this resulted in a finding by the Commissioner that $4,881 of the tax liability reported on the 1953 return of Don Gilmore had never been paid.

(c) The Commissioner of Internal Revenue also determined that of the $5,643.10, which Don Gilmore had paid in 1953 for State income and unemployment taxes, Mr. Gilmore was entitled to a credit in his return of only one-half, or $2,821.55, and that the balance was deductible by Dixie Gilmore.

(d) In his 1953 income tax return, Don Gilmore had erroneously reported that of the $66,799.92 of salaries paid

to him during that year, the amount of $50,099.92 was taxable to himself individually and the balance of $16,700 was taxable to Dixie Gilmore. The error caused his individual income for the year 1953 to be overstated by the amount of $16,699.96. This error was recognized by the Commissioner of Internal Revenue, who made an adjustment showing that only one-half of the total salaries paid were taxable to Don Gilmore individually.

34. As a result of various disallowances and adjustments (including some not now in dispute), the Commissioner assessed deficiencies in income taxes against Don Gilmore as follows:

| *Year* | *Tax* | *Interest* | *Total* |
|---|---|---|---|
| 1953 | $18,883.26 | $4,264.25 | $23,147.51 |
| 1954 | 3,762.21 | 583.12 | 4,345.33 |

Such deficiencies in taxes were paid by Don Gilmore on November 15, 1957, and the interest thereon was paid November 27, 1957.

35. Don Gilmore and Sue Gilmore were married on November 1, 1955, and on April 15, 1956, they filed with the District Director of Internal Revenue at San Francisco their joint income tax return for the calendar year 1955, showing a tax liability of $10,137.52, claiming withholding tax and estimated tax credits of $22,203.21, and asserting an overpayment of $12,065.69. In the return, the taxpayers requested that the overpayment be credited on their 1956 estimated income tax.

36. (a) In the 1955 tax return, Don and Sue Gilmore reported the following:

| *Employer:* | *Wages, etc.* | *Income Tax Withheld* |
|---|---|---|
| Don Gilmore, San Francisco | $20,583.29 | $7,583.29 |
| Don Gilmore, Hayward | 16,800.00 | 6,126.00 |
| Don Gilmore, Riverside | 10,800.00 | 3,544.08 |
| Excess FICA | | 168.00 |
| | 48,183.29 | 17,421.37 |

This return includes all earnings of Don Gilmore during 1955 over which he had complete control, including any share thereof which Dixie Gilmore, his divorced wife, may possibly claim as her share of community income for the period January 1, 1955 to and including the date of the final decree of divorce in October 1955.

(b) In the 1955 return, they also took a deduction of $4,236.66 for "Costs of defending properties and investments—Legal Fees."

(c) As shown by the above-quoted table, the taxpayers in their 1955 return claimed a credit for all taxes withheld from Don Gilmore's salaries in 1955, including the amount withheld prior to October 25, 1955, when the final decree of divorce was entered, as well as the taxes withheld between that date and the end of the calendar year.

37. Don Gilmore received the amount of $42,433.29 as salaries from his employers, Don Gilmore—San Francisco, a corporation, Don Gilmore—Hayward, a corporation, and Don Gilmore—Riverside, a corporation, after December 31, 1954 and prior to October 25, 1955.

In addition Don Gilmore received on October 31, 1955, the following amounts as salaries from his employers for the period from October 16, 1955 to October 31, 1955:

| | |
|---|---|
| From Don Gilmore—Hayward, a corporation | $700.00 |
| From Don Gilmore—Riverside, a corporation | 450.00 |

In addition, Don Gilmore received the amount of $4,600 as salaries from his employers after October 31, 1955, and prior to January 31, 1956.

38. On the basis of the decision in *Waters* v. *Waters*, 170 P. 2d 494 and other authorities, it is the plaintiffs' position herein that all 1955 salaries earned by Don Gilmore prior to October 25, 1955, when the final decree of divorce was entered, were community income of Don Gilmore and Dixie Gilmore. Thus, according to plaintiffs' computation, the $42,433.29 which Don Gilmore earned as salaries from January 1 to October 16, 1955, was community income and that $718.75 of the $1,150 in salaries which he earned in the period from October 16, 1955 to October 31, 1955, is also community income of Don Gilmore and Dixie Gilmore. Plaintiffs' addition of the two amounts yields a total of $43,152.04 as the total 1955 community income of Don and Dixie Gilmore.

39. The taxpayer, Don Gilmore, filed a timely claim for refund of income taxes paid for the year 1953 on the following grounds:

1. 80% of expenses for legal fees of taxpayer's attorneys, and of other costs in divorce proceedings (except fees paid to attorneys for Dixie Gilmore), were incurred and paid during the taxable year for the conservation of the taxpayer's income-producing property. They are therefore deductible expenses. They were erroneously treated by the Commissioner as personal expenditures.

2. The Commissioner had erroneously credited to Dixie Gilmore, and refused to credit to the taxpayer, amounts of income tax withheld from the taxpayer's salary by his employer and which were deposited by taxpayer's employer to the taxpayer's credit with the District Director of Internal Revenue.

3. The Commissioner has erroneously allocated to Dixie Gilmore, and refused to allow as a deduction from the taxpayer's gross income, income taxes paid to the State of California by the taxpayer for his account and not for that of Dixie Gilmore, in the amount of $1,877.17.

4. The Commissioner has erroneously credited to Dixie Gilmore, and disallowed as an expense of the taxpayer, amounts of unemployment insurance tax paid for the taxpayer's account to the State of California. These amounts were expenses of the taxpayer and were not paid for or expenses of Dixie Gilmore.

**40.** The taxpayer, Don Gilmore, filed a timely claim for refund of income taxes paid for the year 1954 on the following grounds:

80% of expenses for legal fees of taxpayer's attorneys, and of other costs in divorce proceedings, were incurred for the conservation of the taxpayer's income-producing property. They are therefore deductible. They were erroneously treated by the Commissioner as personal expenditures.

**41.** The taxpayers, Don and Sue Gilmore, filed a timely claim for refund of income taxes paid for the year 1955 on the following grounds:

Don Gilmore was previously married to Dixie Gilmore, and this marriage was dissolved by a final decree of divorce effective Oct. 25, 1955. Wages, etc. paid to Don Gilmore between Jan. 1 and Oct. 25, 1955, were community income of Don Gilmore and Dixie Gilmore, of which one-half is taxable to Dixie Gilmore. The present taxpayers, Don and Sue Gilmore, erroneously reported all of such income as their community income, and are filing this claim to eliminate from their gross

income the portion thereof which is taxable to Dixie Gilmore.

42. More than 6 months had elapsed after the filing of the above-described claims for refund before this action was brought. No action had been taken by the Commissioner of Internal Revenue on the claims for refund by that time.

DEFENDANT'S COUNTERCLAIM

43. Defendant was granted permission to assert at the trial a counterclaim against Don Gilmore for each of the years 1953 and 1954 for unpaid income taxes assessed against Dixie Gilmore for those years. The counterclaim was filed December 15, 1959, and the allegations thereof were denied by plaintiff, Don Gilmore.

44. Shortly prior to June 19, 1957, an Internal Revenue agent prepared delinquent income tax returns for Dixie Gilmore for the years 1953 and 1954. The agent did not discuss the contents of the returns with Dixie Gilmore, but prepared such returns on the basis of a report made by another Internal Revenue agent who had examined the income tax returns of Don Gilmore for the years 1953 and 1954. After the returns for Dixie Gilmore had been prepared, they were mailed to her for signature, and on June 19, 1957, her then attorney delivered the returns, which had been signed by Dixie Gilmore, to the Internal Revenue Service and they were filed on that date.

The total tax liability reflected by the return for Dixie Gilmore for 1953 was $13,625.78. Against this liability a credit for income tax withheld in the amount of $9,762 was applied, leaving a balance of tax due in the amount of $3,863.78. On December 31, 1957, interest up to that date in the amount of $879.51 was assessed, making a total balance then due of $4,743.29.

The return for Dixie Gilmore for 1954 reflected a total tax liability of $11,958.59. A credit of $11,879.66 for income taxes withheld was applied, thus leaving a balance of $78.93 due for 1954 income taxes. On December 31, 1957, interest of $13.23 was assessed, making a total of $92.16 due as of that date.

45. A demand for the payment of the 1953 and 1954 income taxes and interest was first made on Dixie Gilmore on January 7, 1958, and on March 28, 1958, tax liens were filed against Dixie Gilmore for the unpaid income taxes, plus interest, in Napa County, California. The record does not show what additional attempts, if any, have been made to collect such taxes from Dixie Gilmore.

46. Defendant's counterclaim is based on its contention that during the years 1953 and 1954, Don Gilmore, as the husband of Dixie Gilmore, had full and complete control of the community income and is liable for the unpaid income taxes of Dixie Gilmore, together with the interest due thereon.

47. The final judgment of divorce entered by the Superior Court of Marin County, California, on October 25, 1955, in *Dixie Gilmore* v. *Don Gilmore* provided in part:

> It is FURTHER ORDERED, ADJUDGED AND DECREED that there is no community property belonging to the parties hereto.

48. When the 1953 and 1954 individual income tax returns of Don Gilmore were reviewed and audited by the Internal Revenue Service (finding 33), the report of examination (Exhibit 21), stated that since the interlocutory decree of divorce of June 30, 1953, did not adjudicate community property income rights for the interlocutory period, salaries earned during the interlocutory period constituted community property income and that one-half of such income was legally the income of the taxpayer's former spouse, Dixie Gilmore. As shown in finding 33(d), the Internal Revenue Service adjusted Don Gilmore's 1953 return so as to show that only one-half of the total salaries he received that year was taxable to him individually.

49. On or about October 25, 1955, when the final decree of divorce was entered, the attorneys who represented Dixie Gilmore on appeal demanded an accounting of any accumulations of community property during the period between the interlocutory decree of June 30, 1953, and the final decree of October 25, 1955. It was established at that time that the community income during the period involved was considerably less than payments made by Don Gilmore for community expenses and obligations.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiff is entitled to recover, and judgment will be entered to that effect.

The court further concludes as a matter of law that the defendant is not entitled to recover and, accordingly, its counterclaim is dismissed.

The amount of recovery will be determined pursuant to Rule 38(c) of the Rules of this court.

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# In the Supreme Court

OF THE

# United States

OCTOBER TERM, 1961

No. 255

UNITED STATES,
*Petitioner*

vs.

DON GILMORE AND SUE GILMORE,
*Respondents.*

## BRIEF OPPOSING PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

Respondents Don Gilmore and Sue Gilmore respectfully request that the petition for a writ of certiorari be denied because of the following facts, authorities and reasons:

Respondents' deduction of 80% of the legal expenses in issue is amply supported by these facts found by the Court of Claims:

> "The evidence, particularly the facts set forth in finding 23, establishes that 80 percent or more of the amounts which Don Gilmore paid to his attorneys and his accountant in 1953 and to his

attorneys in 1954 were for services rendered by them to defeat Dixie Gilmore's claims to one-half of the value of the increase of his stock in the three dealership corporations, and to establish that no portion of such stock was community property." (Finding 30; Petition pp. 35, 36)

"If Dixie Gilmore had succeeded in obtaining the community interest she claimed in the stock of the automobile corporations and the dealership contracts held by Don Gilmore had been canceled because of his failure to maintain the minimum ownership of capital required by such contracts, he would have lost his positions and salaries as an officer of the corporations and, as stated in finding 14, he was too old at the time to get a similar position with other automobile dealers." (Finding 29, second paragraph; Petition p. 35)

The Court of Claims stated in its opinion (Petition p. 19): "There can be little doubt that Dixie Gilmore sought more than a divorce. * * * Dixie Gilmore wanted a substantial part of the income-producing property of plaintiff." The court below also said (Petition p. 18): "Thus, plaintiff was fighting not only to protect his income-producing property, but to prevent the loss of his salary as well."

Respondents believe that *Lykes v. United States* (1951) 343 U.S. 118, and *Lewis v. Commissioner* (1958) 253 F. 2d 821, are not authoritative here because of the wide differences in the facts. *Lykes* denied a deduction for legal expenses for services in contesting an imposition of gift taxes. Congress has changed the rule in *Lykes* by statute permitting the deduction.

Internal Revenue Code of 1954, Sec. 212(3); 26 U.S.C. 1958 ed., Sec. 212.

*Lewis* (p. 824) denied a deduction for legal expenses for services (action for legal separation) in respect to "the form and amount of the maintenance and support provisions to be made for petitioner's wife and adjustment of their respective property rights." *Lewis* disapproved (p. 826) of *Baer v. Commissioner*, (1952) 8 Cir., 196 F. 2d 646, because in *Baer* "the sole issue was the form and the amount of alimony to be paid to the taxpayer's wife."

No one questions that legal expenses are not deductible per se for services in resisting demands for alimony, maintenance and support. In *Gilmore* the disputed expenses were not for services in respect to "the form and amount of the maintenance and support provisions to be made for [his] wife and adjustment of their respective property rights" or "* * * the form and the amount of alimony to be paid to [his] wife", as in *Lewis* and in *Baer*. Therefore if there seemed to be a conflict between *Lewis* and *Baer*, *Lewis* not involve *Gilmore*. However, there actually is no conflict in the rule of law between *Lewis* and *Baer*. The court in *Lewis* declined to follow *Baer* on the basis of that court's construction of the facts.

The Court of Claims below did not find it necessary to choose and did not choose between *Lykes* and *Lewis* on the one hand and *Baer* on the other hand. The court recognized that so far as *Gilmore* was concerned the factual differences between the two lines

of cases mentioned made a choice unnecessary. The court below, however, did decide that the facts in *Gilmore* came under the rule of law enunciated in the cases which follow *Baer* (Petition p. 18f, viz.: Although "generally attorneys' fees in a suit for divorce * * * are not deductible" (Reg. 118, Sec. 39.24(a)-1), however, attorneys' fees can be deducted as non-trade or non-business expenses when incurred for the conservation or maintenance of property held for the production of income. (See. Sec. 23(a)(2) Internal Revenue Code 1939)

Respondents will not quarrel with petitioner's assertions (Petition p. 7) that deductibility depends upon the "proximate cause" of the expenditures or "their immediate purpose". These tests are clearly satisfied by the findings of fact of the Court of Claims herein, particularly those findings of fact quoted above at the beginning of this brief. (Findings 29 and 30.) The findings of fact leave no doubt that "the proximate cause" and "the immediate purpose" of the expenditures in issue were not for divorce but as the court stated below, "Dixie Gilmore sought more than a divorce. * * * Dixie Gilmore wanted a substantial part of the income-producing property of plaintiff." (Petition p. 19.) It is not claimed that these findings of fact are not supported by substantial evidence in the record. There is no doubt on that score. The findings of fact must therefore control the disposition of this matter.

In view of the foregoing, it is submitted that *Gilmore* is not the vehicle to resolve the alleged conflict

in decisions. Therefore the petition of the United States should be denied in this case.

Dated, San Francisco, California,
August 7, 1961.

Respectfully submitted,
ELI FREED,
*Attorney for Respondents.*

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# In the Supreme Court of the United States

OCTOBER TERM, 1961

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No. 255

UNITED STATES, PETITIONER

v.

DON GILMORE AND SUE GILMORE

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*ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS*

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No. 256

UNITED STATES, PETITIONER

v.

TALBOT PATRICK, ET AL.

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*ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT*

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## BRIEF FOR THE UNITED STATES

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### OPINIONS BELOW

The opinion of the Court of Claims in *United States v. Gilmore* (G.R. 112–125) [1] is reported as 290 F. 2d

[1] References to the record in *United States v. Gilmore*, No. 255, are prefixed "G.R.": references to the record in *United States v. Patrick*, No. 256, are prefixed "P.R."

942. The opinion of the district court in *United States* v. *Patrick* (P.R. 46–52) is reported at 186 F. Supp. 48, and the opinion of the court of appeals (P.R. 59–67) is reported at 288 F. 2d 292.

## JURISDICTION

The judgment of the Court of Claims in *Gilmore* was entered on June 7, 1961 (G.R. 112, 125). The judgment of the court of appeals in *Patrick* was entered on March 27, 1961 (P.R. 68). On June 24, 1961, by order of the Chief Justice, the time for filing a petition for a writ of certiorari in *Patrick* was extended to and including July 25, 1961. The government's petitions for writs of certiorari in both cases were filed on July 25, 1961, and were granted on October 9, 1961 (G.R. 145, 368 U.S. 816; P.R. 69, 368 U.S. 817). The jurisdiction of this Court in *Gilmore* rests on 28 U.S.C. 1255(1), and in *Patrick*, on 28 U.S.C. 1254(1).

## QUESTIONS PRESENTED

1. In *United States* v. *Gilmore* and *United States* v. *Patrick:*

Whether the portion of a taxpayer-husband's legal expenses, allocable to the property-settlement aspect of a divorce proceeding,[2] are deductible, for income tax purposes, on the theory that they are "ordinary and necessary expenses paid * * * for the management, conservation, or maintenance of property held

[2] In *Gilmore*, the taxpayer-husband paid the legal fees for services rendered in contesting his wife's divorce action, while, in *Patrick*, the taxpayer-husband paid the legal fees for services rendered in negotiating and effectuating the property-settlement agreement.

for the production of income," within the meaning of Section 23(a)(2) of the Internal Revenue Code of 1939 and Section 212(2) of the Internal Revenue Code of 1954.[3]

2. In *United States* v. *Patrick:*

Whether the taxpayer-husband, having been directed by the divorce court to pay, and having paid, legal fees owed by the wife to her attorney for similar services, may deduct those fees under Section 212(2) of the 1954 Code.

## STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Codes and the Treasury Regulations are set forth in the Appendix, *infra,* pp. 43–46.

## STATEMENT

*United States* v. *Gilmore, No. 255*

The pertinent facts, as found by the Court of Claims (G.R. 125–144), may be summarized as follows:

Don Gilmore (the taxpayer) and Dixie Gilmore were married in 1946.[4] They had no children. In April 1952, they separated, and Mrs. Gilmore filed suit for divorce in California, charging her husband with extreme cruelty and adultery. In June of that

[3] In *Gilmore*, both the 1939 and 1954 Codes are applicable because the taxable years involved are 1953, 1954 and 1955; in *Patrick*, only the 1954 Code is applicable because the taxable year involved is 1956.

[4] Sue Gilmore, a party to this proceeding, is the taxpayer's second wife, whom he married on November 1, 1955. She and the taxpayer filed a joint income tax return for 1955. (G.R. 125, 139.)

year, Mr. Gilmore filed an answer and a cross-complaint for divorce, alleging extreme cruelty by Mrs. Gilmore. (G.R. 125–126, 132.)

In the divorce proceedings, Mrs. Gilmore made a claim with respect to the taxpayer's principal income-producing property. The property consisted of holdings in three automobile dealerships which the taxpayer had acquired prior to his marriage.[5] The stockholdings had increased in value by $600,000 (from $200,000 to $800,000) between 1946 and 1952. Mrs. Gilmore claimed that this increment was community property under the laws of California. Prior to the divorce trial, Mrs. Gilmore had offered to take $275,000 in full settlement of her claim, but the taxpayer rejected the offer because he feared that a settlement might result in a cancellation of his dealership franchises and because his attorneys had advised him that the increment in the value of his holdings was separate property. (G.R. 130–131.)

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[5] The taxpayer's stockholdings were as follows: 100 percent of the outstanding shares of Don Gilmore-San Francisco; 60 percent of the outstanding shares of Don Gilmore-Riverside; and 73⅓ percent of the outstanding shares of Don Gilmore-Hayward. Each of these enterprises was a California corporation which operated as a franchised automobile dealer of a division of the General Motors Corporation. During the taxable years, and for many years previously, the taxpayer was the president and principal managing officer of each of the corporations. He derived substantial income in the form of salaries and dividends from the corporations, largely due to his ownership and control. During 1953 and 1954, the taxpayer's only income from sources unrelated to the corporations was $1,024.90 and $516.60, respectively. He had spent all of his adult life in the retail automobile business, which was the only business he knew. (G.R. 127–129.)

At the divorce trial, most of the evidence presented by the parties was devoted to the alleged misconduct. Some, though considerably less, testimony was directed to the question whether the increase in the value of the taxpayer's stock in the automobile dealerships was community property.* After Mrs. Gilmore took the initiative in presenting evidence of misconduct, Mr. Gilmore's attorneys considered it necessary to resist those charges by extensive cross-examination and by evidence of misconduct on Mrs. Gilmore's part. This was undertaken because (1) under California law, the court must award more than 50 percent of the community property, and may award all of it, to the innocent spouse in divorces based on extreme cruelty or adultery; (2) Mrs. Gilmore's charges of misconduct were published in the local newspapers, and it was feared that General Motors might cancel the taxpayer's dealership franchises if the allegations were proved; (3) the credibility of the parties became an important factor, and the taxpayer's attorneys feared that, if the trial judge believed Mrs. Gilmore's account, he might also find that there was community property and award all or most of it to her; and (4) there was presented an issue whether oral declarations and conduct between the parties had affected the nature of the property in dispute. (G.R. 132–133.)

* Other issues presented were whether Mrs. Gilmore was entitled to alimony and whether two houses in which the parties had lived were held in joint tenancy. The taxpayer's attorneys devoted little time and effort to these issues. (G.R. 133.)

In 1953, after trial, the Superior Court found the issues in favor of the taxpayer, granting him an interlocutory divorce, denying Mrs. Gilmore a divorce, and holding that there was no community property of the marriage. On October 25, 1955, after an appeal, a remand of the case, and further proceedings in which the Supreme Court of California affirmed the interlocutory judgment of the Superior Court, a final judgment of divorce in favor of the taxpayer was entered in the trial court.[1] (G.R. 126.)

As a result of the protracted litigation, the taxpayer was required to pay a total of about $45,911.36 in legal fees for the years 1953, 1954 and 1955 ($32,537.15 for 1953; $8,074.21 for 1954; and approximately $5,300 for 1955). In his income tax returns for 1953 and 1954 (the years here involved), the taxpayer deducted a substantial portion of the legal fees as an expense incident to defending properties and investments. The Commissioner disallowed the deductions on the ground that the legal fees were personal expenditures and therefore nondeductible under Section 24(a)(1) of the Internal Revenue Code of 1939 (App., *infra*, p. 43). The deficiencies were paid and this suit for refund followed. (G.R. 134–136, 138, 140, 141–142.)

In the proceedings below, taxpayer claimed, and the Court of Claims held (R. 112–120), that 80 percent of of his legal fees were deductible under Section 23(a)(2) of the Internal Revenue Code of 1939 (App., *infra*, p. 43) as having been incurred in the conserva-

[1] The two residences were held to be property held in joint tenancy (R. 126).

tion of his income-producing property" (G.R. 119).[8] The court stated that "plaintiff was fighting not only to protect his income-producing property, but to prevent the loss of his salary as well" (G.R. 117), and then observed (G.R. 119) that

> * * * in every divorce case a certain amount of legal expenses are incurred for the purpose of obtaining the divorce and a certain amount are incurred in an effort to conserve the estate and are not necessarily deductible under section 23(a)(2), but when the facts of a particular case clearly indicate that the property, around which the controversy evolves, is held for the production of income and without this property the litigant might be denied not only the property itself but the means of earning a livelihood, then it must come under the provisions of section 23(a)(2) * * *.

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*United States* v. *Patrick, No. 256*

Talbot Patrick, the taxpayer,[9] was sued for divorce by his then wife, Paula M. Patrick, on December 16, 1955, in the Court of Common Pleas for York County, South Carolina. In her complaint, Paula sought an absolute divorce, court supervision of division of the properties, an appropriate property settlement, cus-

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[8] The remaining 20 percent was allocated to obtaining the divorce as distinguished from protecting the property.

[9] The word "taxpayer" is used to refer only to Talbot Patrick, although the administrator of the estate of his second wife, Alethia M. Patrick, is a party to this suit because the income tax return for the year in question, 1956, was filed on a joint return basis (P.R. 46).

tody of the minor children, and attorneys' fees. The taxpayer, in his answer to Paula's claim, neither admitted nor denied the alleged grounds for divorce (adultery) and he did not testify at the hearing during the course of the divorce action. The divorce court subsequently issued a final decree of absolute divorce, approved the property settlements made by the parties in an "Amended Stipulation and Agreement", and, by reference, required the payment by taxpayer of attorneys' fees. (P.R. 7, 46–47.)

The "Amended Stipulation and Agreement" (P.R. 7–14), which incorporated the parties' property settlement agreement, was the result of extended negotiations between counsel for both parties while the divorce action was pending (P.R. 47). Since adultery is a ground for absolute divorce in South Carolina and the taxpayer made no defense, the wife was entitled to a substantial property settlement (P.R. 49).

The property settlement agreement provided for payments by taxpayer for the support and maintenance of the parties' children (P.R. 9–11) and contained provisions relating to specific property. The taxpayer and his wife were each to receive one of the two family residences (P.R. 8). Although they jointly owned various properties (P.R. 4), the only income-producing property covered by the agreement consisted of (1) stock in the Herald Publishing Company, of which the taxpayer was president and treasurer (as well as editor and publisher of its newspaper), and (2) a parcel of real estate which was in part leased and used by the publishing company (P.R. 3, 4, 11).

The stock of the publishing company had all been owned or held in trust for members of the taxpayer's family. The taxpayer owned 28 percent of the stock; his wife, 28 percent; and their adult son Hugh, 9 percent. In addition, 7 percent was in a trust fund for Hugh, and a 14 percent interest was in each of two other trust funds for the benefit of each of two minor children, Wayne and Paula. (P.R. 4.)

The wife and her attorneys were satisfied with the taxpayer's management of the corporation and the editorial position of the newspaper (P.R. 50–51). They considered that the wife's best interests would be served if the taxpayer continued to control and manage the corporation (R. 51). The wife made no immediate threats upon the taxpayer's operation or control of the newspaper and did not seek to enjoin the alienation or encumbrance of his interest; nor did she question his right, title or interest in the corporate shares (P.R. 23–24, 28, 32, 37–38, 43–46). The property settlement agreement provided that the taxpayer would purchase his wife's 28 percent interest in the publishing company and that the stock would pass to the children upon his death or that, if the interest were sold, the proceeds would become the property of the children (P.R. 5, 11–12).

The real estate expressly covered by the property settlement agreement was located on West Main Street in Rock Hill, South Carolina. Prior to the agreement, the taxpayer had an 80 percent undivided interest in this property, which was in part leased to, and used by, the Herald Publishing Company, and his wife had a 20 percent undivided interest. (P.R. 4.)

Under the property settlement agreement, both taxpayer and his wife's interests in this property were to be placed in a trust, the property was to be leased to the Herald Publishing Company for ten years (with options for renewal), and the net income of the trust was to be paid to the wife for life and then to the children. The trust was to terminate when the youngest child reached the age of 21, at which time the property was to be conveyed to the children. (P.R. 5, 8–10.)

The attorneys' fees incurred by each party, relating to the divorce action and accompanying settlement agreement, were $12,000, a total of $24,000. Pursuant to the settlement agreement and divorce decree, the taxpayer paid the entire amount.[10] By agreement between counsel and the parties, the total fees of $24,000 were allocated as follows: $4,000 for the handling of the divorce; $4,000 for the handling of the real estate property—$3,200 charged to the taxpayer and $800 to the wife, in proportion to their prior 80 and 20 percent ownership; and $16,000 for the handling of the interests in the Herald Publishing Company. (P.R. 47.)

The district court held that the taxpayer was entitled to deductions in 1956, totaling the $19,200 claimed, which covered (1) the $16,000 in attorneys' fees paid by the taxpayer to his own and his wife's attorneys for handling the settlement in relation to the

[10] The publishing company paid $16,000, but the taxpayer later repaid this amount to the company. The district court held that the company's payment was a loan to the taxpayer (P.R. 48). The government did not appeal this ruling.

parties' interests in the Herald Publishing Company and (2) the $3,200, which was the taxpayer's share of the $4,000 allocated to the settlement of the real estate property (P.R. 46–52).

The court of appeals affirmed (P.R. 59–67). In the course of its opinion, the court admitted that "[t]he wife made no immediate threat" to the taxpayer-husband's specific "income-producing property" (P.R. 61, 65), but nevertheless went on to hold that "the legal fees incurred by the taxpayer in maintaining and conserving his income-producing property are deductible under [the 1954] Code Section 212(2) [App., *infra*, p. 44]" (P.R. 66). The court stated (P.R. 65):

> It is true the wife, in this case, did not commit an overt act, to either enjoin, damage or encumber the taxpayer's income-producing property. This was not necessary. We conclude that all of the taxpayer's income-producing properties were in great peril until and unless a satisfactory settlement agreement was concluded.

## SUMMARY OF ARGUMENT

### I

The present cases sharply illustrate the proposition that the adjustment of intra-familial obligations arising out of the termination of the marriage relationship is typically a matter far removed from the "ordinary and necessary expenses paid * * * for the management, conservation, or maintenance of property held for the production of income * * *," the subject matter of Section 23(a)(2) of the Internal Revenue Code

of 1939 and Section 212(2) of the Internal Revenue Code of 1954. Contrary to the courts below, the government contends, that a husband's legal expenses allocable to the property-settlement aspect of a divorce proceeding are not deductible because they do not come within the coverage of Sections 23(a)(2) and 212(2) but are instead "personal, living, and family" expenses within the meaning of Section 24(a)(1) of the 1939 Code and Section 262 of the 1954 Code.

A. Ever since the first income tax law was enacted in 1913, the various Revenue Acts have drawn a distinction between "business" and "personal" expenses. Prior to 1942, only "the ordinary and necessary expenses paid or incurred * * * in carrying on any trade business" were deductible (Section 23(a)(1)(A) of the 1939 Code). Expenses incurred in nontrade or nonbusiness profit-seeking activities were considered by this Court as not being deductible because they had not been "paid or incurred * * * in carrying on any trade or business." To correct this rule which it believed inequitable, Congress added, in 1942, the present subsection (a)(2) to Section 23 to provide for a class of deductions for expenses incurred in nontrade and nonbusiness profit-seeking activities which were to be "coextensive with the business deductions allowed by § 23(a)(1), except for" the requirement that the expenses be incurred in a "trade or business" (*Trust of Bingham* v. *Commissioner*, 325 U.S. 365, 374). With this one exception, deductions under subsection (a)(2) were to be subject to *all* the restrictions and limitations which applied to deductions under subsection (a)(1)(A). Under no

circumstances did the new subsection "authorize widespread deductibility of personal, living or family expenditures" (*Lykes* v. *United States*, 343 U.S. 118, 122). The expenses for which deductions were authorized under Section 23(a)(2) were therefore more akin to "business" expenses in the nontechnical sense than to "personal" expenses, and Section 23(a) as a whole retained its original character as a provision for the deduction of "business"—or at least "business"-type—expenses. The same language of Section 23(a)(2) was carried over into Section 212 of the 1954 Code.

B. According to the tests established by this Court, the deductibility of legal expenses turns upon the nature of the activities to which the legal expenses relate and upon the origin and immediate purpose of the expenses. The legal expenditures must be an expense of a profit-seeking activity and must be incurred in, or arise or grow out of, the conduct of that activity. The expenditures cannot be merely an incidental cause of, or make a remote contribution to, the conservation or maintenance of income-producing property. Thus, it is clear that legal expenses incurred during the course of a divorce proceeding—whether they be to contest the divorce, to resist the liability for alimony, or to negotiate a property settlement—are not "ordinary and necessary expenses paid * * * for the * * * conservation * * * or maintenance of property held for the production of income" (Section 23(a)(2) of the 1939 Code). Although the legal expenses may minimize the material effects of the divorce by holding to a mini-

mum the amount necessary to effectuate the property settlement, the protection of the property is merely the incidental effect of the expenses. The origin and immediate purposes of the expenses do not arise out of the conduct of the husband's profit-seeking activity. Rather, their origin is in the marital rift or termination of the marital relationship, an obviously "personal" or "family" matter.

C. In holding that the legal expenses incurred by a husband in connection with the property-settlement aspect of a divorce proceeding were deductible under Section 23(a)(2) of the 1939 Code and Section 212(2) of the 1954 Code, the courts below purported to follow a line of authority which originated with *Baer* v. *United States*, 196 F. 2d 646 (C.A. 8th). The test adopted by the court in *Baer*, and by the courts which have followed *Baer*, may be articulated in the following way: although legal expenses connected with a divorce proceeding are ordinarily nondeductible as "personal" expenses, they nevertheless may be deducted as "ordinary and necessary expenses paid" for the "conservation" or "maintenance" of income-producing property, provided that (1) the husband does not contest the divorce and (2) concedes his liability for alimony, but incurs the legal expenses, (3) because of the urgency of resisting his wife's demands (4) with respect to specific income-producing property (5) out of which he earns his livelihood, in order to arrive as a satisfactory adjustment of his liability in a property settlement.

The basic flaw in the *Baer* test is that it fails to distinguish between the incidental effect of the legal ex-

penditures on the conservation or maintenance of the husband's position with respect to his specific income-producing property and the origin of the legal expenses which is in the marital rift and divorce.

The second basic error in the *Baer* test is that it emphasizes the urgency of resisting the wife's demands even though this Court in *Lykes* v. *United States, supra,* 343 U.S. at 125, noted that neither the "size" of the liability nor the "urgency" of resisting it "determined its character."

*Baer* also erroneously distinguishes between the husband's expenditure of legal fees in order to protect specific income-producing property out of which he earns his livelihood, which is considered deductible, and the husband's expenditure of legal fees in order to protect his general assets by holding to a minimum the amount necessary to effect a property settlement, which is considered not deductible. But in *Lykes* (343 U.S. at 126), this Court looked with displeasure on the "substantial uncertainty and inequity [which] would inhere" in such a distinction.

Finally, *Baer* attempts to draw an impracticable line of demarcation between what is and what is not deductible, which can only engender confusion in its application. Thus in *Gilmore,* the Court of Claims, though relying on *Baer,* allowed the taxpayer a deduction of 80 percent of the legal expenses he incurred in contesting both the divorce and his liability for the settlement of property, while in *Patrick* the Fourth Circuit went off in the opposite direction in relying on *Baer* but applying it to a completely amicable divorce and property setlement in which there was no

immediate threat by the wife to any specific income-producing property and in which even the incidental effect of the legal fees had no relevance to the "conservation" or "maintenance" of income-producing property.

D. Even if the personal nature of the contested legal expenditures were to be ignored, a portion of the expenditures in *Gilmore* and all of the expenditures in *Patrick* would be nondeductible as being capital in nature. In *Gilmore,* to whatever extent the legal expenses were attributable solely to contesting the wife's claim that the $600,000 appreciation in value of the taxpayer's stockholdings in his automobile dealerships was community property, the legal expenses were incurred in the defense of title to property and were therefore nondeductible capital expenditures. On the other hand, under the property-settlement agreement in *Patrick,* the husband relinquished his 80 percent undivided interest in the real estate, retained his 28 percent stock interest in the publishing company, and purchased his wife's 28 percent stock interest in the company. If the negotiation had been considered an arms length transaction, the expenses of acquiring and disposing of the property would have been considered capital in nature and therefore nondeductible except as an offset in computing gain on the disposition of the property involved.

II

The court in *Patrick* so completely misconceived the language and purpose of Section 212(2) of the 1954 Code that it even allowed the taxpayer to deduct

the attorneys' fees which his wife incurred in relation to the rearrangement of the stock interest in the publishing company, and which the taxpayer became obligated to pay under the property settlement incorporated in the divorce decree. All the reasons for disallowing the deductions for the taxpayer's own attorneys' fees are equally applicable to his wife's attorneys' fees. Indeed, since the wife was the taxpayer's adversary in the divorce proceedings and employed the attorneys to protect her own interest, her attorneys' fees could hardly have been incurred for the purpose of conserving or maintaining the taxpayer's own income-producing property. Actually, of course, the payment of the wife's fees was a part of what the taxpayer paid in satisfaction of his liability to his wife by virtue of the divorce, which was akin to alimony, but not deductible as such, because the fees were not in the form of periodic payments.

## ARGUMENT

### I

### THE LEGAL EXPENSES INCURRED BY A HUSBAND IN CONNECTION WITH THE PROPERTY-SETTLEMENT ASPECT OF A DIVORCE PROCEEDING ARE NOT DEDUCTIBLE, FOR INCOME TAX PURPOSES, AS HAVING BEEN PAID FOR THE CONSERVATION OR MAINTENANCE OF INCOME-PRODUCING PROPERTY WITHIN THE MEANING OF SECTION 23(a)(2) OF THE INTERNAL REVENUE CODE OF 1939 AND SECTION 212(2) OF THE INTERNAL REVENUE CODE OF 1954

Both courts below held that a husband may deduct that portion of his legal expenses allocable to the property-settlement aspect of a divorce proceeding, on the theory that the legal expenses are "ordi-

nary and necessary expenses paid * * * for the management, conservation, or maintenance of property held for the production of income * * *" within the meaning of Section 23(a)(2) of the Internal Revenue Code of 1939 (App., *infra*, p. 43) and its counterpart in the Internal Revenue Code of 1954, Section 212(2) (App., *infra*, p. 44). The government contends that these legal expenses are not deductible because they do not come within the coverage of Sections 23(a)(2) and 212(2) but rather are "'personal' living and family expenses" within the meaning of Section 24(a)(1) of the 1939 Code (App., *infra*, p. 43) and Section 262 of the 1954 Code (App., *infra*, p. 44). See Treasury Regulations 118, Sec. 39.24(a)-1, App., *infra*, p. 45; Treasury Regulations on Income Tax (1954 Code), Sec. 1.262-1(b)(7), App., *infra*, p. 46).[11] The present cases sharply il-

[11] The Treasury Regulations make one exception to the general rule that attorneys' fees paid in a suit for divorce or separate maintenance are not deductible, *i.e.*, the part of an attorney's fee which is properly attributable to the production or collection of periodic payments of alimony, which are includible in the gross income of the wife under Section 22(k) of the 1939 Code and Section 71 of the 1954 Code. This alimony income generally would be taxable to the husband instead of the wife if it were not for Sections 22(k) and 71. See *Douglas* v. *Willcuts*, 296 U.S. 1; *Commissioner* v. *Lester*, 366 U.S. 299. In this situation the attorneys' fees are incurred in the conduct of a profit-seeking activity, and allowance of the deduction is consistent with the Congressional policy of allowing a deduction for the expenses of producing taxable income. It is noteworthy that the deduction is not for all the wife's attorneys' fees, nor even for all of her attorneys' fees for services related to a property settlement; it is only for those fees which are allocable to the periodic payments of alimony which are taxed to the wife.

lustrate the proposition that the adjustment of intra-familial obligations arising out of the termination of the marriage relationship is typically a matter far removed from the ordinary and necessary expenses of engaging in profit-seeking activities implicit in the holding of property for the production of income—the subject matter of Section 23(a)(2) of the 1939 Code and Section 212(2) of the 1954 Code. The present cases also show how far the courts below have gone in misconceiving or ignoring the language and purpose of the statutes involved.

A. ONLY ORDINARY AND NECESSARY EXPENSES INCURRED IN CARRYING ON, OR ENGAGING IN, A PROFIT-SEEKING ACTIVITY ARE DEDUCTIBLE

Ever since the first income tax law was enacted in 1913, the various Revenue Acts have drawn a distinction between "business" and "personal" expenses. Thus, Section II B of the Income Tax Act of 1913, c. 16, 38 Stat. 167, authorized deduction of "the necessary expenses actually paid *in carrying on any business*, not including personal, living, or family expenses * * *" (emphasis added). In the 1939 Code, prior to 1942, the deduction provision was contained in Section 23(a)(1)(A) (App., *infra*, p. 43), which allowed a deduction for "[a]ll the ordinary and necessary expenses paid or incurred * * * in carrying on any trade or business."[12] Because of the words of limitation, "trade or business", used in Section 23(a)(1)(A), taxpayers who incurred expenses in non-

[12] This precise language dates back to Section 214(a)(1) of the Revenue Act of 1918, c. 18, 40 Stat. 1057.

trade or nonbusiness profit-seeking activities, such as looking after one's own security investments, were denied a deduction because their expenses were not "paid or incurred * * * in carrying on any trade or business." See *Higgins* v. *Commissioner*, 312 U.S. 212; *City Bank Co.* v. *Helvering*, 313 U.S. 121; *United States* v. *Pyne*, 313 U.S. 127.

It was "[t]o change that result" (*Lykes* v. *United States*, 343 U.S. 118, 121) that Congress added, in 1942, the present subsection (a)(2) to Section 23 of the 1939 Code.[13] In order to correct the "inequity" of making "nontrade or nonbusiness income" taxable but not allowing "nontrade or nonbusiness expenses" to be deducted,[14] Congress allowed a deduction in the new subsection (a)(2) for "all the ordinary and necessary expenses paid or incurred" (1) "for the production or collection of income" or (2) "for the management, conservation, or maintenance of property held for the production of income." See *McDonald* v. *Commissioner*, 323 U.S. 57, 61. Except for technical changes, this language in Section 23 (a)(2) is still retained in the 1954 Code in Sections 212(1) and (2) (App., *infra*, p. 44).[15]

Section 23(a)(2) was characterized by this Court in *Trust of Bingham* v. *Commissioner*, 325 U.S. 365, 373, 374, as being "comparable and *in pari materia*

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[13] The addition was made by Section 121 of the Revenue Act of 1942, c. 619, 56 Stat. 798.

[14] H. Rep. No. 2333, 77th Cong., 2d Sess., p. 46 (1942-2 Cum. Bull. 372, 410); see, also, 3 Hearings on the Revenue Revision of 1942 Before the House Committee on Ways and Means, 77th Cong., 2d Sess., pp. 2801–2803, 3291; 88 Cong. Rec. 6376.

[15] The language in Section 23(a)(1) has also been retained in the 1954 Code in Section 162 (App., *infra*, p. 44).

with § 23(a)(1)" in that it provided "for a class of nonbusiness deductions coextensive with the business deductions allowed by § 23(a)(1), except for" the requirement that the expenses be incurred in a "trade or business". Thus, as the Committee Reports stated, "except for the requirement of being incurred in connection with a trade or business," a deduction under Section 23(a)(2) was to be "subject * * * to all the restrictions and limitations that apply in the case of the deduction under Section 23(a)(1)(A) of an expense paid or incurred in carrying on any trade or business." H. Rep. No. 2333, 77th Cong., 2d Sess., p. 75 (1942–2 Cum. Bull. 372, 430); S. Rep. No. 1631, 77th Cong., 2d Sess., p. 88 (1942–2 Cum. Bull. 504, 571); quoted in *McDonald* v. *Commissioner, supra,* 323 U.S. at 62, n. 4; *Lykes* v. *United States, supra,* 343 U.S. at 122, n. 7; see Treasury Regulations 111, Sec. 29.23(a)–15(b); Treasury Regulations 118, Sec. 39.23(a)–15(d), App., *infra,* p. 44. Since Section 23(a)(1)(A) applied only to expenses incurred "in carrying on" a trade or business, Section 23(a)(2) was also only to apply to expenses incurred "in carrying on," or engaging in, a nontrade or nonbusiness profit-seeking activity. See *McDonald* v. *Commissioner, supra,* 323 U.S. at 62; *Trust of Bingham* v. *Commissioner, supra,* 325 U.S. at 374, 375.

The effect of the amendment was explained by the Court in *McDonald* v. *Commissioner, supra,* 323 U.S. at 61–62 (emphasis added): "[Since] Congress adopted the * * * [new subsection] for the restricted purpose" of allowing "deductions *from profitable*

*transactions* not covered by the statutory concept of 'business' income * * *," Congress "merely enlarged the *category of incomes* with reference to which expenses were deductible * * * [but] did not enlarge the *range of allowable deductions* of 'business' expenses." See, also, *Trust of Bingham* v. *Commissioner, supra,* 325 U.S. at 373–374. In other words, Section 23(a)(2) was to permit only "the deduction of some, but not all, of the nontrade and nonbusiness expenses of an individual taxpayer" (*Lykes* v. *United States, supra,* 343 U.S. at 121–122); nothing in the legislative history of the subsection indicated that "Congress sought to make such a change of policy as would authorize widespread deductibility of personal, living or family expenditures in the face of [Section 24(a)(1)]" (*id.* at 122; see *Lewis* v. *Commissioner*, 253 F.2d 821, 825 (C.A. 2d)).

Since the deductions under subsection (a)(2) were limited to expenses incurred in carrying on a nontrade or nonbusiness profit-seeking activity, the expenses could neither be classified as "trade or business" expenses in the technical sense or as "personal" expenses. But since the expenses were to be incurred in a profit-seeking activity, they could at least be characterized as being more akin to "business" expenses in the nontechnical sense than to "personal" expenses. Section 23(a) as a whole, therefore, still retains its original character as a provision for the deduction of "business"—or at least "business"-type—expenses; subsections (a)(1) and (a)(2) together provide that "insofar as an individual taxpayer engages in *a profit-seeking activity,* he may deduct from gross income the

expenses incurred *in that activity*, limited only by the requirement that the expenses be both 'ordinary and necessary' * * *'' (*Lewis* v. *Commissioner, supra*, 253 F. 2d at 825 (emphasis added)).

B. LEGAL EXPENSES INCURRED BY A HUSBAND IN CONNECTION WITH THE PROPERTY-SETTLEMENT ASPECT OF A DIVORCE PROCEEDING ARE NOT INCLUDED IN CARRYING ON, OR ENGAGING IN, A PROFIT-SEEKING ACTIVITY; RATHER, THEY ARE PERSONAL IN NATURE AND ARE THEREFORE NOT DEDUCTIBLE

1. According to the tests established by this Court, the deductibility of legal expenses "turns * * * upon the nature of the activities to which * * * [the legal expenses] relate" (*Lykes* v. *United States, supra*, 343 U.S. at 123; accord, *Commissioner* v. *Heininger*, 320 U.S. 467, 472). "It is the kind of transaction out of which the obligation arose * * * which * * * [is] crucial and controlling" (*Deputy v. du Pont*, 308 U.S. 488, 496); "* * * it is the origin of the liability out of which the expense accrues which is material" (*id.* at 494). The legal expenditures must be an expense "of" the profit-seeking activity (*Interstate Transit Lines* v. *Commissioner*, 319 U.S. 590, 593) or they must be incurred "in" that activity (*Lewis v. Commissioner, supra*, 253 F. 2d at 825); they must be expenses arising or "growing directly out of the conduct" of that activity (*Kornhauser* v. *United States*, 276 U.S. 145, 151).

Thus, in *Trust of Bingham* v. *Commissioner, supra*, this Court held that legal expenses incurred by trustees of a testamentary trust in contesting an income tax deficiency and winding up the trust were deductible under Section 23(a)(2) because the expenses were

considered to be "directly connected with or proximately result[ing] from the *conduct of the business*" and "an integral part of *carrying out the trust enterprise*" (325 U.S. at 374, 375 (emphasis added)). In *McDonald* v. *Commissioner, supra,* however, campaign expenditures incurred by a judge in running for reelection were held to be nondeductible under Section 23(a)(2) because "they were not incurred in 'carrying on' his 'business' of judging" (323 U.S. at 62).

Similarly, in *Lykes* v. *United States, supra,* the taxpayer was not allowed a deduction for attorney fees incurred in contesting a gift-tax deficiency for gifts of stock in a closely-held family corporation to his children because the origin of the legal expenses was in the gift, a personal matter, and not in a profit-seeking activity with which Section 23(a)(2) is concerned.[14] In answering the taxpayer's contentions that the attorneys' fees had been incurred in an attempt to conserve his property from the asserted gift-tax liability, the Court stated (343 U.S. at 125):

> Legal expenses do not become deductible merely because they are paid for services which relieve a taxpayer of liability. That argument * * * would mean that the expense of defending almost any claim would be deductible by a taxpayer on the ground that such defense was

[14] The specific result of the *Lykes* case was altered by the addition of subsection (3) to Section 212 of the 1954 Code, which allows deductions "in connection with the determination, collection, or refund of any tax"—the scope of which provision is now being considered in *Davis* v. *United States*, No. 268, this Term. The amendment did not affect the application of *Lykes* to subsection (a)(2) of Section 23 of the 1939 Code or subsections (1) and (2) of Section 212 of the 1954 Code.

> made to help him keep clear of liens whatever income-producing property he might have. For example, it suggests that the expense of defending an action based upon personal injuries caused by a taxpayer's negligence while driving an automobile for pleasure should be deductible.

Although the Court recognized that every asserted liability, if justified, would have the effect of reducing income-producing resources of a taxpayer, and that expenditures for legal fees incurred to counteract, defeat, negotiate, or minimize such liabilities could be considered as relating to the "conservation" or "maintenance" of income-producing property, the Court rejected such an all-inclusive test of deductibility. Rather, it held that Section 23(a)(2) is to be applied "to expenses on the basis of their *immediate purposes* rather than upon the basis of the *remote contributions* [or the incidental effect] they might make to the conservation of a taxpayer's income-producing assets by reducing his general liabilities" (343 U.S. at 125 (emphasis added)). The mere threat of consumption of the taxpayer's income-producing property was not enough (*id.* at 126). See Treasury Regulations on Income Tax (1954 Code), Sec. 1.212-1 (m), App., *infra*, p. 46.

2. From the tests established by this Court, it is clear that legal expenses incurred during the course of a divorce proceeding—whether they be to contest the divorce, to resist the liability for alimony, or to negotiate a property settlement—are not "ordinary and necessary expenses paid * * * for the * * * conservation * * * or maintenance of property held

for the production of income" within the meaning of Section 23(a)(2) of the 1939 Code or Section 212(2) of the 1954 Code. The most that can be said for those legal expenses is that they are used to minimize the material effect of the divorce by holding to a minimum the amount necessary to effectuate the property settlement. Even though the expenditures may benefit the husband by protecting his income-producing property, the protection of the property is merely an incidental effect of the legal expenses. The origin and the immediate purpose of the legal expenses are not in the husband's trade or business or profit-seeking activity. The expenses are not incurred in, are not a part of, and do not arise or grow out of the conduct of the husband's profit-seeking activity."[17] Rather, the legal expenses connected with a divorce have their orgin in the marital rift or in the termination of the marital relationship, an obviously "personal" or "family" matter, within the meaning of Section 24(a)(1) of the 1939 Code and Section 262 of the 1954 Code (see Treasury Regulations 118, Sec. 39.24(a)-1; Treasury Regulations on Income Tax (1954 Code), Sec. 1.262-1(b)(7)).

3. The "personal" origin of the legal expenses connected with a divorce is indicated by the facts of the present cases. In *Gilmore*, the reasons

[17] Of course, when legal expenses are actually incurred in protecting a business or other profit-seeking activity they may be deductible under Section 23(a) if they have their origin in the conduct of the activity. See *Commissioner* v. *Heininger*, 320 U.S. 467.

given for the allowance of the deduction were that the taxpayer-husband faced a possible loss of income, a possible loss of 50 percent or more of his stock in his automobile dealerships, and could have lost his dealership franchises (G.R. 117); that he "was fighting not only to protect his income-producing property, but to prevent the loss of his salary as well" (G.R. 117); that "[i]t is not too difficult to imagine that an irate ex-wife, if she gained control of a corporation, would dispose of her ex-husband as president" (G.R. 117); and that "[t]he sensational nature of the divorce charges of adultery and misconduct, brought by Dixie Gilmore, were published in the local papers" and "[t]his adverse publicity created a real fear that General Motors might terminate" taxpayer's franchises "if the allegations were established and a divorce granted to the wife" (G.R. 118). In brief, the legal expenses were incurred by the taxpayer-husband to defend and protect himself against the consequences of his wife's charges of misconduct and adultery. The origin of the expenses was of an exceptionally personal character.

In *Patrick*, an agreement was reached whereby the husband acquired the wife's shares for a price, thus assuring his continuing control of the company. Significantly, an important condition was attached—that the children were to have a remainder interest in all of the husband's shares, both those previously held and those acquired under the settlement purchase. As to the real property involved, the husband completely relinquished his 80 percent undivided interest, placing it in trust for the wife during her life, with

the remainder over to the children. (P.R. 5, 8–12.) It seems patent, therefore, that the settlement, although completely amicable, was nevertheless an adjustment of intra-familial obligations, typically a matter far removed from the subject of Section 23(a)(2) of the 1939 Code or Section 212(2) of the 1954 Code.

C. IN FOLLOWING THE CRITERIA FOR DETERMINING DEDUCTIBILITY UNDER THE LINE OF AUTHORITY WHICH ORIGINATED WITH *BAER* V. *UNITED STATES*, THE COURTS BELOW HAVE VIOLATED THE TESTS AND PRINCIPLES FOR DETERMINING DEDUCTIBILITY ENUNCIATED BY THIS COURT.

By distinguishing (G.R. 117; P.R. 63–64) this Court's decision in *Lykes* v. *United States*, *supra*, and by adhering to the criteria established in the line of authority which originated with the Eighth Circuit's decision in *Baer* v. *United States*, 196 F. 2d 646, the courts below failed to follow the tests and principles enunciated by this Court for determining the deductibility of legal expenses incurred by a husband in connection with the property-settlement aspect of a divorce proceeding and held those expenses to be deductible under Section 23(a)(2) of the 1939 Code and Section 212(2) of the 1954 Code.[13]

[13] Prior to the present cases, the *Baer* doctrine was followed by the Sixth Circuit (*Bowers* v. *Commissioner*, 243 F. 2d 904) and the Fifth Circuit (*Owens* v. *Commissioner*, 275 F. 2d 251); rejected by the Second Circuit (*Lewis* v. *Commissioner*, 253 F. 2d 821) and the Tax Court (*Douglas* v. *Commissioner*, 33 T.C. 349; *Estate of Walsh* v. *Commissioner*, 28 T.C. 1274; *Joyce* v. *Commissioner*, 3 B.T.A. 393, 397); and distinguished or not followed by the Third Circuit (*Smith's Estate* v. *Commissioner*, 208 F. 2d 349) and the Ninth Circuit (*Howard* v. *Commissioner*, 202 F. 2d 28; *Tressler* v. *Commissioner*, 228 F. 2d 356; *Harris* v. *United States*, 275 F. 2d 238). The Fourth Circuit purported to follow the *Baer* case in *Patrick*. Although the

The test adopted by the court of appeals in *Baer*, and by those courts which have followed *Baer* (see *Bowers* v. *Commissioner*, 243 F. 2d 904 (C.A. 6th); *Owens* v. *Commissioner*, 273 F. 2d 251 (C.A. 5th); *McMurtry* v. *United States*, 132 F. Supp. 114 (C. Cls.)), may be articulated in the following way: although legal expenses connected with a divorce proceeding are ordinarily nondeductible as being "personal" expenses (see Treasury Regulations 118, Sec. 39.24(a)-1; Treasury Regulations on Income Tax (1954 Code), Sec. 1.262-1(b)(7)), they nevertheless may be deducted as "ordinary and necessary expenses paid * * * for the * * * conservation * * * or maintenance of property held for the production of income," provided that (1) the husband does not contest the divorce and (2) concedes his liability for alimony, but incurs the legal expenses, (3) because of the urgency of resisting his wife's demands (4) with respect to specific income-producing property (5) out of which he earns his livelihood, in order to arrive at a satisfactory adjustment of his liability in a property settlement.[19]

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Court of Claims purported to adhere to *Baer* in *Gilmore* and in *McMurtry* v. *United States*, 132 F. Supp. 114, it did not apply *Baer* in *Davis* v. *United States*, 287 F. 2d 168, now pending on certiorari on other issues, Nos. 190 and 268, this Term.

[19] In *Baer*, a portion of the husband's legal expenses was held to be deductible under Section 23(a)(2) as having been paid for the conservation or maintenance of income-producing property. In that case, the taxpayer-husband had been sued for divorce by his wife who, in addition to other matters, demanded from him a lump sum payment in excess of $1,000,000. Satisfaction of the wife's demands would have required the husband to sell a considerable portion of his stock in a corporation

1. *Baer erroneously fails to distinguish between the incidental effect and the origin of the expenses.*—The basic flaw in the test adopted in *Baer* is that it fails to distinguish between (1) the incidental effect of the legal expenses, and their remote contribution to the conservation or maintenance of the husband's position with respect to certain specific income-producing property and (2) the nature and kind of transaction out of which the obligation arises and the origin of the liability out of which the legal expenses accrue, *i.e.*, the marital rift and divorce. By holding that the legal expenditures "had a proximate and direct relation *to* the conservation and maintenance of specific property * * *" (196 F. 2d at 651 (emphasis added)), the court in *Baer* completely ignored the basic criterion established by this Court for deduction under Sections 23(a)(2) and 212(2), that the legal expense must have their origin in or be "directly connected with or proximately result * * * from the conduct of the business" of holding the specific property for the production of income (*Trust of Bingham* v. *Commissioner, supra,* 325 U.S. at 374).

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which he controlled and from which his income was mainly derived in the form of salary and dividends. Although the husband did not contest the divorce or resist his liability for alimony, he did resist his wife's efforts to obtain a gross settlement because he was concerned about the possibility of breaking up his block of stock in the corporation and the effect it would have on his control and future in the business. Through the efforts of his attorneys, a property settlement was worked out by which the husband was placed in a position to meet his obligations to his wife and yet remain in control of the corporation and of his stock in the corporation.

2. *Baer erroneously emphasizes the urgency of resisting the wife's demands.*—The second basic error in the test formulated in *Baer* is that the deductibility of the legal expenses is supposed to stem in part from the urgency of resisting the demands which the wife makes with respect to specific income-producing property in satisfaction of the husband's property-settlement liabilities. Presumably the court believed that the urgency of resisting the wife's demands is directed toward the conservation or maintenance of the property. But this Court in *Lykes* specifically held that neither the "size" of the liability nor the "urgency" of resisting it "determined its character" (343 U.S. at 125); rather, deductibility turned "upon the nature of the activities to which * * * [the legal expenses] relate[d]" (*id.* at 123).

3. *Baer erroneously distinguishes between specific income-producing property and general assets.*—A further misconception in *Baer* is that it makes a distinction between the husband's expenditure of legal fees in order to protect specific income-producing property out of which he earns his livelihood and the husband's expenditure of legal fees in order "to hold to a minimum the amount necessary to effect a property settlement" (*Davis* v. *United States*, 287 F. 2d 168, 172 (C. Cls.)). In the former case, according to *Baer*, the legal expenses are deductible under Section 23(a)(2) of the 1939 Code and Section 212(2) of the 1954 Code, but, in the latter case, the legal expenses are "personal" within the meaning of Section 24(a)(1) of the 1939 Code and Section 262 of the

1954 Code, and are therefore not deductible. In *Lykes*, this Court noted with displeasure the "substantial uncertainty and inequity [which] would inhere" in a rule under which one taxpayer "might be permitted to deduct from his taxable income the same expense for precisely the same services as those upon which his less well-to-do neighbor would have to pay a tax * * *" (343 U.S. at 126). Whether liability in a property settlement is resisted or merely adjusted, or whether the liability relates to specific income-producing property or merely to the general assets of the taxpayer, the source and origin of the legal expenses in connection with the property settlement are the same—the marital rift and the termination of the marital relationship. Despite this fact, *Baer* would allow some husbands a deduction for their legal expenses and others not, depending on the specific nature of the husband's wealth and the specific claims of the wife. Such a distinction has no place under our present tax statutes.

4. *Baer draws an impracticable line of demarcation for determining deductibility.*—Beyond the distinction between specific income-producing property and general assets, *Baer* attempts to draw an impracticable line of demarcation between what is and what is not deductible—one which can only engender confusion in its application and which has in fact engendered confusion in the present cases.

(*a*) In *Gilmore*, the Court of Claims allowed the taxpayer-husband a deduction of 80 percent of the legal expenses he incurred in contesting both the divorce and his liability for the settlement of property,

on the theory that defending and protecting himself against the consequences of his wife's charges of misconduct and adultery were related to the conservation of his income-producing property. In so doing, the court recast the test in *Baer* to allow a deduction under Section 23(a)(2) "when the facts of a particular case clearly indicate that the property, around which the controversy evolves, is held for the production of income and without this property the litigant might be denied not only the property itself but the means of earning a livelihood * * *" (G.R. 119).

(*b*) In *Patrick*, on the other hand, the Fourth Circuit distinguished the *Lykes* and *Lewis* cases from the *Baer* case on the ground that in *Lykes* "[t]he fees were incurred in contesting * * * [the tax] deficiency or in resisting liability" and in *Lewis* the legal "fees were spent in resisting legal separation proceedings and liability," whereas, in *Baer*, the fees were spent in negotiating the property settlement (P.R. 64). The Fourth Circuit then went off in the opposite direction, however, in relying on the *Baer* decision but applying it to a completely amicable divorce and property settlement in which there was no immediate threat by the wife to any specific income-producing property and in which even the incidental effect of the legal fees had no relevance to the "conservation" or "maintenance" of income-producing property.

In *Patrick*, the only income-producing property of the taxpayer which was involved in the settlement negotiations was his 28 percent stock interest in the Herald Publishing Company and an undivided 80 percent interest in the real estate which was leased to

that company. The wife owned a 28 percent stock interest in the publishing company, and the children the remaining interest. The wife also owned a 20 percent interest in the real estate.

"Because of the family unity which had existed" (P.R. 65) prior to the marital discord, the taxpayer had been able to control the publishing company and thus insure his positions as corporate president and treasurer and as editor and publisher of the newspaper, from which he derived salaries. The imminent divorce, which destroyed the family unity, meant that the taxpayer could have lost his control of the publishing company, and that, as the court below stated (P.R. 65), the wife could have acquired the right to partition or force a sale of the income-producing property which housed the publishing company. But the wife was satisfied that the management of the corporation and the editorial policies of the newspaper were sound, and she was not disposed to assume the responsibility of providing the corporation with new competent leadership and of continuing the newspaper (P.R. 50–51).

The negotiations with respect to the property settlement culminated in an agreement under which the taxpayer purchased his wife's 28 percent stock interest in the publishing company and relinquished his 80 percent undivided interest in the real estate leased to the publishing company. His purchase of his wife's 28 percent stock interest was subject to conditions requiring him to turn over the sale proceeds to the children if he sold the stock, and, if no sale occurred, the stock was to pass automatically to the

children upon the taxpayer's death. (P.R. 11–12.) The taxpayer's 80 percent undivided interest in the real estate, along with the wife's 20 percent undivided interest, was put in trust for the payment of the net income to the wife for life, with remainders over to the children (P.R. 8–10.)

Clearly, the taxpayer's relinquishment of his 80 percent undivided interest in the real estate leased to the publishing company hardly qualifies as a "conservation" or "maintenance" of income-producing property. Cf. *Lykes* v. *United States, supra; Trust of Bingham* v. *Commissioner, supra.* Nor did the court below hold otherwise; rather, it stressed that the taxpayer might have lost control of the publishing company (P.R. 65–66) and concluded, therefore, that all of the taxpayer's income-producing properties were "in great peril" (P.R. 65) and in "danger" (P.R. 66) unless and until a satisfactory property settlement agreement was concluded. But the "peril" or "danger" was minimal and, more important, related only to the possible loss of the taxpayer's control of the publishing company—which he previously had not because of a controlling interest, but "[b]ecause of the family unity which had existed" (P.R. 65). The "danger" was not that he would lose his 28 percent stock interest in the publishing company, but that, because of the break-up of the family unity, he might lose his income from the publishing company by losing his salaried positions with it. Perhaps the court below was aware of this fact, for it stated at one point (P.R. 66 (emphasis added)) that the legal fees were spent for services

"designed to find a means in which the taxpayer could meet these liabilities [to his wife and children] without destroying his *income* and his income-producing *status*". In any event, as the court below conceded (P.R. 65), the wife made no demands and took no action to endanger taxpayer's income-producing property as such. Therefore, the attorneys' fees paid by the taxpayer for services in negotiating the settlement agreement—although paid "to find a means in which the taxpayer could meet these liabilities" to his wife and children (P.R. 66)—did not even have the incidental effect of, or make a remote contribution to, conserving income-producing property on which *Baer* and similar cases had erroneously predicated the allowance of a deduction under Section 23(a)(2). In fact, contrary to the assumption of the court below and unlike the situation in the typical *Baer*-type case, the taxpayer was not even dependent upon the publishing company for a livelihood. His gross income for the taxable year was over $55,000, of which $15,000 consisted of salaries, and $5,400 consisted of dividends, both received from the publishing company (P.R. 5, 25–26). Accordingly, less than half of his income was from the publishing company (P.R. 26).

In essence, the Fourth Circuit extended the erroneous criteria of *Baer* to reach an even more paradoxical result. On the one hand, the court placed great emphasis upon maintenance of the taxpayer's control of the publishing company, purporting to be concerned with the management, conservation, or maintenance of his specific income-producing property. On the other

hand, the court completely ignored the fact that, under the settlement agreement, the taxpayer purchased his wife's 28 percent stock interest in the publishing company and thereby *acquired* the stock control of the company which he did not have previously.

D. EVEN IF THE PERSONAL NATURE OF THE CONTESTED LEGAL EXPENDITURES WERE TO BE IGNORED, A PORTION OF THE EXPENDITURES IN *GILMORE* AND ALL OF THE EXPENDITURES IN *PATRICK* WOULD BE NONDEDUCTIBLE AS BEING CAPITAL IN NATURE

1. In *Gilmore*, even if the contested legal fees[20] were not considered personal expenses, a portion of the fees would have to be considered as nondeductible capital expenditures. The only substantial income-producing property which could have been affected by the divorce proceedings was the husband's stock in his three automobile dealerships. His possible loss of stock control and income from the businesses stemmed from his wife's claim that the $600,000 appreciation in the value of his stock was community property. (See G.R. 130–131.) "The question of community property was an important one during the divorce proceedings" (G.R. 114). But these possible losses—possible because the greater share of the community property might have been awarded to the wife if she had obtained a divorce on her misconduct charges—

[20] In *Gilmore*, 20 percent of the fees were considered personal, as relating directly to the divorce contest itself (see the Statement, *supra*, pp. 6–7); of the 80 percent remaining, only that portion relating to the $600,000 appreciation of stock could be considered as capital in nature.

would not occur if the $600,000 appreciation in the value of the stock was not community property. Thus, "[i]n preparation for and during the trial of the divorce suit, Don Gilmore's attorneys devoted considerable effort in establishing that no portion of the increase in the value of his stock constituted community property" (G.R. 133), and, therefore, a portion of the legal expenses held to be deductible by the court below was incurred by the taxpayer in the defense of title to property. Expenditures for that purpose constitute capital expenditures which are nondeductible. See Treasury Regulations 118, Sections 39.23(a)-15(e), (k), 39.24(a)-2(a), App., *infra* pp. 44–45; *Harris* v. *United States*, 275 F. 2d 238 (C.A. 9th); *Shipp* v. *Commissioner*, 217 F. 2d 401 (C.A. 9th). In fact under circumstances strikingly similar to those in the present case, the Ninth Circuit, in *Harris* v. *United States*, *supra*, 275 F. 2d at 240, denied the taxpayer's claim to a deduction under Section 23(a)(2) on the ground that "the attorney fees were paid to resist the wife's claim that there was community property."

2. Similarly, in *Patrick*, even if the personal nature of the contested legal fees [21] were to be ignored, the fees

[21] In *Patrick*, the $4,000 in fees paid for handling the divorce were disallowed as being personal in nature and the $800 in fees charged to the wife, but paid by the husband, with respect to the real estate was never claimed as a deduction (see the Statement, *supra*, p. 10); all of the remaining fees could have been considered as capital in nature.

might then be considered nondeductible capital expenditures. If it be assumed that the property settlement agreement were an arm's-length agreement between two unrelated parties which involved nothing more than the two income-producing properties of the taxpayer, *i.e.*, his 28 percent stock interest in the publishing company and his 80 percent undivided interest in the real estate, then the portion of the $16,000 which the taxpayer paid to his own attorneys for rearranging the stock ownership and control of the publishing company (P.R. 47) could be considered to have been paid for services which resulted in the taxpayer's purchase of his wife's 28 percent stock interest in the company. But "[e]xpenses incurred to acquire title to property are capital in nature and are not deductible * * *." *Lewis* v. *Commissioner, supra,* 253 F. 2d at 828; see Treasury Regulations on Income Tax (1954), Section 1.212–1(q), App., *infra,* pp. 45, 46; cf. *Welch* v. *Helvering,* 290 U.S. 111.

Moreover, the $3,200 in attorneys' fees allocated for the handling of the real estate (P.R. 47) was for services performed in disposing of the taxpayer's 80 percent undivided interest in the real estate. Except with respect to dealers, expenses incurred in connection with the disposition of property are normally deemed to be capital in nature and treated as an offset against the sales price, rather than as expenses. See *Spreckels* v. *Commissioner,* 315 U.S. 626; *Munson* v. *McGinnes,* 283 F. 2d 333 (C.A. 3d).

II

THE LEGAL FEES PAID BY THE TAXPAYER IN *PATRICK* TO HIS WIFE'S ATTORNEYS PURSUANT TO THE SETTLEMENT AGREEMENT AND DIVORCE DECREE ARE NOT DEDUCTIBLE UNDER SECTION 212(2) OF THE INTERNAL REVENUE CODE OF 1954

Under the settlement agreement incorporated into the divorce decree, the taxpayer in *Patrick* was required to pay the legal fees incurred by his wife in the divorce proceeding, which totalled $12,000 (P.R. 47). The Fourth Circuit held that the wife's share of the total of $16,000 in attorneys' fees allocated to the rearranging of stock ownership and control of the Herald Publishing Company, just like the taxpayer's share of legal fees paid to his own attorneys, was deductible under Section 212(2) (P R. 66). The court's explanation for his incongruous holding (P.R. 66) was that "[t]he taxpayer's liability for his legal fees and the legal fees for his wife would not have been incurred except for the necessity of the long and extended negotiations culminating in" the property settlement agreement; that the fees were incurred solely for the purpose of preserving, maintaining and conserving the taxpayer's income-producing property; that the "only test of deductibility * * * is whether or not the expenses were reasonable and proximately related to the management, conservation and maintenance of income-producing property"; and that "[i]t makes no difference to whom they are paid."[22]

[22] The court below relied upon *Owens* v. *Commissioner*, 273 F. 2d 251 (C.A. 5th), as authority for its holding. But in *Owens*, the Fifth Circuit, following *Baer*, held that the hus-

The court's holding with respect to the wife's legal expenses demonstrates its erroneous view of Section 212(2) perhaps even more than its holding that the taxpayer was entitled to deduct his own attorneys' fees. A contention similar to that of the present taxpayer was summarily rejected by the Second Circuit in *Lewis* v. *Commissioner, supra*, 253 F. 2d at 828. Obviously, the wife's attorneys' fees were a part of what the taxpayer paid in satisfaction of his liability to his wife by virtue of the divorce. Thus, it would have been more logical for the taxpayer to have claimed that his wife's attorneys' fees were deductible as alimony, although such a contention would have had to be rejected because the legal fees were not in the form of periodic payments. See *Baer* v. *Commissioner, supra*, 196 F. 2d at 649; *Norton* v. *Commissioner*, 192 F. 2d 960 (C.A. 8th); *Richardson* v. *Commissioner*, 234 F. 2d 248 (C.A. 4th). See, also, n. 11, *supra*, p. 18.

Moreover, all the reasons for disallowing the deduction for the taxpayer's own attorneys fees are equally applicable to his wife's attorney fees. Even if the wife's attorneys' fees had not been paid by the taxpayer merely in satisfaction of his liability to his wife, the fees would have been nonetheless nondeductible, for they were personal expenses, having had their origin in the termination of the marital relationship, instead of the "business"-type or profit-seeking-type of expense for which Section 212(2) allows a

---

band was entitled to deduct the fee which he paid to his wife's attorney *for services rendered to him, not to her*, even though it expressed some concern with the propriety of an attorney acting as a representative of two supposedly adversary parties.

deduction (see *supra*, pp. 23–28, 30). Furthermore, the wife's attorneys' fees could hardly have had even a remote relation to the "conservation" or "maintenance" of the taxpayer's income-producing property, since they were incurred by the wife in furtherance, not of the taxpayer's interests, but of her own interests as an adversary in the divorce proceeding. Cf. *Magruder* v. *Supplee*, 316 U.S. 394. Even if the wife's attorneys' fees had been incurred for the taxpayer's benefit, the fees would have been capital expenditures incurred in the acquisition and disposition of title to property (see *supra*, pp. 38–39). The allowance of the deduction of the wife's legal fees highlights how far the Fourth Circuit below has gone in misconceiving or ignoring the language and purpose of the statute.

## CONCLUSION

For the foregoing reasons, the judgments of the courts below should be reversed.

Respectfully submitted.

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JANUARY 1962.

# APPENDIX

Internal Revenue Code of 1939 (26 U.S.C. 1952 ed.):

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [as amended by Sec. 121(a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.

(2) *Non-trade or non-business expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

* * * * *

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

(1) [as amended by Sec. 127(b) of the Revenue Act of 1942 *supra*] Personal, living, or family expenses * * * [with certain exceptions].

* * * * *

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 162. TRADE OR BUSINESS EXPENSES.

(a) *In General.*—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.

* * * * *

SEC. 212. EXPENSES FOR PRODUCTION OF INCOME.

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property held for the production of income * * *.

* * * * *

SEC. 262. PERSONAL, LIVING, AND FAMILY EXPENSES.

Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.

Treasury Regulations 118:

SEC. 39.23(a)-15 *Nontrade or nonbusiness expenses.* * * *

* * * * *

(d) Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23(a)(1)(A) of an expense paid or incurred in carrying on any trade or business. This includes restrictions and limitations contained in section 24. * * *

(e) Capital expenditures, and expenses of carrying on transactions which do not constitute a trade or business of the taxpayer and

are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income * * *, are not allowable as nontrade or nonbusiness expenses. * * *

* * * * *

(k) Expenditures incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of * * *) * * * constitute a part of the cost of the property and are not deductible expenses. Attorneys' fees paid in a suit to quiet title to lands are not deductible * * *.

* * * * *

SEC. 39.24(a)-1 *Personal and family expenses.*—* * * Generally, attorneys' fees paid in a suit for divorce or separate maintenance are not deductible. However, the part of an attorney's fee paid in a divorce or separate maintenance proceeding which is properly attributable to the production or collection of amounts includible in gross income under section 22(k) is deductible under section 23(a)(2). * * *

SEC. 39.24(a)-2 *Capital expenditures.*—(a) *Expenditures except non-depreciable mine development expenditures.*—* * * The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. * * *

Treasury Regulations on Income Tax (1954 Code):

SEC. 1.212-1 *Nontrade or Nonbusiness Expenses.* * * *

* * * * *

(c) Expenses of carrying on transactions which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income * * *

are not allowable as nontrade or nonbusiness expenses. * * *

* * * * *

(m) An expense (not otherwise deductible) paid or incurred by an individual in determining or contesting a liability asserted against him does not become deductible by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability.

(n) Capital expenditures are not allowable as nontrade or nonbusiness expenses. * * *

* * * * *

SEC. 1.262–1 *Personal, Living, and Family Expenses*—(a) *In general.*—In computing taxable income, no deduction shall be allowed, except as otherwise expressly provided in chapter 1 of the Internal Revenue Code of 1954, for personal, living, and family expenses.

(b) *Examples of person, living, and family expenses.*—Personal, living, and family expenses are illustrated in the following examples:

* * * * *

(7) Generally, attorney's fees and other costs paid in connection with a divorce, separation, or decree for support are not deductible by either the husband or the wife. However, the part of an attorney's fee and the part of the other costs paid in connection with a divorce, legal separation, written separation agreement, or a decree for support, which are properly attributable to the production or collection of amounts includible in gross income under section 71 are deductible by the wife under section 212.

* * * * *

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# In the Supreme Court
OF THE
# United States

OCTOBER TERM, 1951

No. 231

UNITED STATES,
*Petitioner,*
vs.
DON GILMORE and SUE GILMORE,
*Respondents.*

**On Writ of Certiorari to the United States Court of Claims**

## BRIEF FOR RESPONDENT DON GILMORE

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# In the Supreme Court
OF THE
# United States

OCTOBER TERM, 1961

No. 255

UNITED STATES,
*Petitioner,*
vs.
DON GILMORE and SUE GILMORE,
*Respondents.*

On Writ of Certiorari to the United States Court of Claims

## BRIEF FOR RESPONDENT DON GILMORE

### QUESTIONS PRESENTED

1. Whether amounts paid for legal services by a husband (Don Gilmore) to defeat his wife's (Dixie Gilmore's) claims made in a divorce action, to one-half of the increase in value of his shares of stock in three corporations controlled by him, are deductible, for income tax purposes, as "ordinary and necessary expenses paid * * * for the * * * conservation, or main-

tenance of property held for the production of income", as provided by Section 23 (a)(2) of the Internal Revenue Code of 1939 and Section 212 (2) of the Internal Revenue Code of 1954.[1]

2. A subsidiary question is whether the legal expenses found to be deductible by the court below should in part be held to be capital expenditures in defense of title to property.

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## STATUTES AND REGULATIONS INVOLVED

Appellee supplements in the Appendix, infra pp. i-iii, additional provisions of statutes and regulations not included in the Appendix of Petitioner.

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## STATEMENT

Appellee adds to the "Statement" of Petitioner the following facts found to be true by the court below.

Dixie Gilmore claimed that the increase in value of Don Gilmore's stock was community property under California law because the increase consisted of money earned by virtue of the personal services of Don Gilmore to the corporations. (R. 130, F. 19.)[2] Don Gilmore was advised by his attorneys that any increase in the value of his stock as the result of his personal efforts or services during his marriage was recognized

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[1]Sue Gilmore married Don Gilmore in 1945; the issues before this court involve 1953 and 1954 only. (R. 125, 142.)

[2]The letter "F" used herein denotes the Findings of Fact of the Court of Claims.

by California law as community property. (R. 131, F. 20(e).)

The court below found that: "The evidence, particularly the facts set forth in finding 23, establishes that 80 percent or more of the amounts which Don Gilmore paid to his attorneys and his accountant in 1953 and to his attorneys in 1954 were for services rendered by them to defeat Dixie Gilmore's claims to one-half of the value of the increase of his stock in the three dealership corporations, and to establish that no portion of such stock was community property." (R. 137, F. 30.)

In 1952 and 1953 Don Gilmore was sixty-two years of age and he was too old to get another job as president and general manager of an automobile dealership, except through a controlling stock ownership interest. (R. 129, F. 14.) He received the following salaries from such employment:

| | |
|---|---|
| 1949 | $79,800.00 |
| 1950 | 61,316.65 |
| 1951 | 66,799.92 |
| 1952 | 66,799.92 |

(R. 128, F. 9.)

Don Gilmore was paid such salaries only because of his controlling stock ownership interest in the corporations employing him. His compensation for corresponding positions would have to be greatly reduced if he were employed by corporations which he did not own outright or control. (R. 129, F. 13.)

If Don Gilmore's wife succeeded in obtaining the community interest (increase in value of his stock)

and the dealership contracts of the corporations were canceled as a result thereof. Don Gilmore would have lost his positions and his salaries, and he was too old at the time to get similar positions with other automobile dealers. (R. 136, 137, E. 29.)

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## SUMMARY OF ARGUMENT

The court below found it to be a fact that 80 percent or more of the amounts which Don Gilmore paid for legal expenses were for services to establish that no part of his stock in the three dealership corporations consisted of community property and to defeat his wife's claims to one-half of the increase in value of such stock. It is unquestioned that this finding is supported by the record. In so finding the court below also determined as a fact that the remaining 20 percent of the legal expenses was personal, that is, for services in respect to the issues of divorce (including alimony) and the two residences.

Admittedly, the stock owned by Don Gilmore in the three corporations consisted of property which he held for the production of income. Thus 80 percent of the legal expenses were found as a fact by the court below to be for the conservation of property held for the production of income. Therefore Section 23 (a) (2) of the 1939 Code and Section 212(2) of the 1954 Code are definitely applicable to 80% of the legal expenses.

The court below found that the dominant and primary purpose of the services of the attorneys and the

accountant was to conserve such property held for the production of income. It follows that the remaining 20 percent was for services of a personal nature which came within Section 24 (a) (1) of the 1939 Code and Section 262 of the 1954 Code.

Although Don Gilmore and Dixie Gilmore were married they also had a community property relationship of a quasi business character. The community property system in California creates sort of a partnership between husband and wife. All earnings of the spouses from their services are owned equally by them as community property. They share community income, gains and losses equally. Claims which they may make against each other in respect to such community property relate to their rights and duties in respect to such property relationship. A husband and wife in California may make contracts with respect to property and may deal with each other in regard thereto just as unmarried persons.

Although the stock in the three corporations was of paramount importance to Don Gilmore, there was also of supreme importance to him the positions that he had in the three corporations from which he realized substantial compensation. The maintenance of his employment and his compensation from his employment were conditional on his continued ownership of the controlling stock interests in the three corporations. Therefore, to maintain his employment, it was necessary for him to keep control of the three corporations through his stock ownership. It follows that the expenditures which he made were vitally related

to the conservation of his positions in the three corporations.

To deny the deduction of the expenses which the court below held to be for the conservation of property held for the production of income would be to disregard the findings of fact of the court below and the words of the statute (Section 23 (a)(2) and Section 212 (2)) and would defeat the obvious purpose of the statute.

None of the legal expenses in issue should be treated as capital expenditures because they were not paid to defend or perfect title to income-producing property. Don Gilmore had complete title to the stock in the corporations before marriage and he had the same title after marriage. His wife did not claim that he did not have title. In fact, her rights, if any, depended on his having title. His title to the stock was clear and marketable. The defense against Dixie Gilmore's claims was not calculated to enhance the value of the stock. The claim made by Dixie Gilmore to the increase in value of the stock was a claim to accumulated community income which was alleged to be reflected in the increase in value of the stock. Even though the increment or appreciation in value alleged to be due to accumulated community income was unrealized, nevertheless, her claim was to 50 percent of a gain in value. From this viewpoint it would seem that the legal expenses in issue were paid by Don Gilmore to protect his right to the unrealized gain in the value of his stock. It would thus follow that contrary to regarding the legal expenses as capital

expenditures, an alternative ground is presented for duction by Don Gilmore of the legal expenses under Section 23 (a)(2), viz., as expenses proximately related to the production or collection of income.

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## ARGUMENT

### THE COURT OF CLAIMS WAS CORRECT ON THE BASIS OF ITS FINDINGS OF FACT IN DETERMINING THAT EIGHTY PERCENT OF THE LEGAL EXPENSES PAID BY DON GILMORE WERE DEDUCTIBLE AS EXPENSES FOR SERVICES RENDERED FOR THE CONSERVATION AND MAINTENANCE OF PROPERTY HELD FOR THE PRODUCTION OF INCOME.

The record clearly shows that Dixie wanted a substantial part of the income-producing property of Don Gilmore; that is what the fighting was about. The court below determined as an ultimate fact that Don Gilmore paid 80% of the legal expenses to protect his income-producing property. That findings of fact of the Court of Claims are conclusive, see *U.S. v. Esmault-Pelteria*, 58 S. Ct. 412, 414, 303 U.S. 26, 29; *Niles-Bement Pond Co. v. U.S.*, 281 U.S. 357, 360, 50 S. Ct. 251, 252. He also made some expenditures for legal services which more directly related to his marital rights and obligations. In effect the court below determined that the issue relating to the community property rights was divisible and severable from the issues of divorce and alimony. In the words of the court in *Orcutt v. Commissioner*, 273 F. 2d 251 (5 Cir.), the "domestic dispute furnished the occasion, but not the motive, for the payment of the $7,500 to the attorney."

The testimony of Wallace Myers, chief trial attorney for Don Gilmore in the Superior Court of California, shows that neither party was interested in defeating each other's claim for divorce to save the marriage (see F. 17, R. 129); and it also illustrates the relative unimportance of the divorce and alimony issues compared with the main issue of the claim made by Dixie to community property alleged to be reflected in the increase in value of Don Gilmore's stock. On cross-examination by Mr. Pester, government counsel, Wallace Myers testified as follows (R. 88, 89 and 90):

"Mr. Pester. Q. You were engaged in the trial of this case for about 21 days?

A. 24 trial days.

Q. 24 trial days?

* * * * * * *

Mr. Pester. Q. Let's eliminate from this Gilman divorce action the community property issue. Upon the trial of the case, on all the other issues involved, what would you consider a reasonable attorney's fee?

A. Well, in the first place, the case wouldn't have lasted two days, and I would have probably charged him about $1,000.

Q. You mean it wouldn't last two days with all this conduct issue in it?

A. We would have never gone into it. She could have walked into Court and had a divorce and gotten alimony for a reasonable time, and there would never have been a fight. We were not fighting about alimony.

Q. Well, you were fighting the divorce, and the conduct of Mr. Gilmore——

A. We only had to fight it because she was asking for something like $300,000 in money that didn't belong to her, and she was trying to taint that with community property.

Q. Isn't it a fact that you also fought on the conduct issue?

A. Certainly we fought on the conduct issue.

Q. Wouldn't that have taken more than a day or two days?

A. Well, may I put it this way, Mr. Pester: If you are fighting over $1,000, you don't try a 24-day case. I don't. That case wouldn't have lasted two days, because we would have never really pressed it.

Q. But the $1,000 wasn't involved in the conduct issue, was it?

A. The conduct issue was only involved because there was $600,000 or thereabouts of property involved. That is the only reason."

It becomes clear from a consideration of the findings of ultimate fact by the court below and from the record supporting the findings that the primary and dominant issue was not the divorce or alimony but protection of income-producing property and Doy Gilmore's salaries from the corporations, both being his source of income. It is in this light that the language in the opinion of the court below (R. 119), quoted in Petitioner's Brief[3] at page 7, becomes meaningful. To repeat, the court stated that:

"* * * in every divorce case a certain amount of legal expenses are incurred for the purpose of

[3]Hereafter reference to Petitioner's Brief will be by the letters "P.B."

> obtaining the divorce and a certain amount are incurred in an effort to conserve the estate and are not necessarily deductible under section 23 (a)(2), but when the facts of a particular case clearly indicate that the property, around which the controversy evolves, is held for the production of income and without this property the litigant might be denied not only the property itself but the means of earning a livelihood, then it must come under the provisions of section 23(a)(2) * * *."

By such statement the court means that when the evidence shows that expenditures for legal services are made primarily to conserve income-producing property, the fact that such expenditures are made for services in a divorce proceeding does not change the primary purpose of the expenditures.

Contrary to the assertion made in Petitioner's Brief (P.B. 17), the court below did not allocate the legal expenses in question to the "property-settlement aspect of a divorce proceeding". In *Gilmore* there was an early attempt at property settlement which was abandoned before trial. (R. 130, 131.) The fight on the question of community property took place in court. The issue was litigated, not settled. The legal expenditures were not made to resist financial demands for alimony or any liability. Legal services were not rendered to rearrange or adjust property rights between the spouses. Dixie Gilmore made a direct attack against Don Gilmore's stock. She used every means at her command. Don Gilmore's legal expenditures in question related only to the defense and protection of his stock and what it entailed.

**MUST THERE BE A PROFIT-SEEKING ACTIVITY OF A BUSINESS TYPE FOR THE APPLICATION OF SECTION 23(a)(2) AND SECTION 212(2)?**

Petitioner asserts (P.B. 22), despite the plain language of Section 23(a)(2) and Section 212(2) which permits deduction of ordinary and necessary expenses incurred "for the management, conservation, or maintenance of property held for the production of income", that deductibility should be limited to "business"-type expenses. Appellee submits that the court in *Lewis v. Commissioner* (2 Cir.) 253 F. 2d 821, 825, which used the term "profit-seeking activity" did not necessarily mean that the "profit-seeking activity" to which the expense should relate must be an expense of a "business" type. It should be observed that the statutory language of Section 23(a)(2) and Section 212(2) requires that the expenses relate to "property held for the production of income". Whether the holding of property for the production of income is an activity in the business sense seems beside the point. In *Bingham's Trust v. Commissioner of Internal Revenue*, 325 U.S. 365, 65 S. Ct. 1232, 1237, the court stated that Section 23(a)(2) is comparable and *in pari materia* with Section 23(a)(1) authorizing the deduction of business or trade expenses and that "the effect of Section 23(a)(2) was to provide for a class of nonbusiness deductions coextensive with the business deductions allowed by § 23(a)(1), except for the fact that since they were not incurred in connection with a business, the section made it necessary that they be incurred for the production of income or the management or conservation of property held for the pro-

duction of income". It will be observed that the court in *Bingham's Trust* makes reference to the introductory title of Section 23(a)(2) which characterizes the expenses as "non-trade or non-business" expenses. Is it not reasonable to interpret this language to mean that the type of expenses involved are "non-business" type expenses rather than "business" type expenses? Whether the activity is characterized as profit-seeking or income-seeking would seem to be immaterial insofar as the proper meaning of Section 23(a)(2) is concerned. The use of the term "profit-seeking" should not lead to the conclusion that what is intended by the statute is necessarily a business-kind of expense.

---

**THE LEGAL EXPENSES INCURRED BY DON GILMORE WERE INCURRED IN AND ABOUT A COMMUNITY PROPERTY RELATIONSHIP.**

Because the legal concept of the community property system is so foreign to that of the common law, it is frequently very difficult for the legal mind trained and versed in the common law to grasp and understand its principles. It is a mistake to understand it and interpret it by the principles and terminology of the common law. 1 de Funiak Principles of Community Property, pp. 7 and 8. Chief Justice Stone of the United States Supreme Court said, while Attorney General of the United States, that the confusion in the decisions of the California courts with respect to community property undoubtedly arose "from the fact that the courts have been attempting in their opinions to apply the terminology of the com-

mon law to community property which embodies a legal concept wholly foreign to the common law and to which the terminology of the common law cannot be applied with accuracy and precision." 34 Op. Atty. Gen. 395. It is said: "Generally, the relationship between the spouses with respect to community property is regarded as being in the nature of a partnership." 10 Cal. Jur. 2d 665. Again: "The general theory is that the husband and wife form a sort of partnership, and that property acquired during the marriage by the labor or skill of either belongs to both." 4 Witkin Summary of California Law 7th Ed., 2705. And "* * * during the existence of the marital relationship the spouses are the joint owners, or partners, with respect to gains and losses." 1 de Funiak Principles of Community Property 3. Also, either husband or wife may enter into an engagement or transaction with the other respecting property which either might do if unmarried. California Civil Code § 158.

The quasi-business relationship between the husband and wife based on the community property system in California is discussed by de Funiak, supra, at page 8. In commenting on the general misunderstanding of the law of community property, he states:

> "It may sometimes arise because of the mistaken belief that the community property system substitutes some sort of a cold blooded partnership for marriage as a sacrament, that it substitutes a business relationship for what they consider a sacred relation between husband and wife."

In a footnote (20) on page 9, the following comment is made:

> "Actually the marital partnership in the common earnings and gains is not a substitute for but something in addition to marriage as a sacrament (or status or whatever one views it as being). The marital partnership in the earnings and gains may be dissolved by agreement during the marriage without in any way affecting the subsistence of the marriage itself. * * * '* * * matrimony is only the occasion for the partnership which the spouses have in the profits and the cause of this partnership is the law which establishes it'."

Whether the community property relationship is characterized as a quasi-business relationship, a partnership, a profit-seeking activity, or an income-seeking activity, a dispute between spouses over community property provides a separate issue independent of the issue of divorce. As to divisibility of the issue of divorce from other issues between husband and wife, see *Estin v. Estin* (1948) 334 U.S. 541, 68 S. Ct. 1213; *Vanderbilt v. Vanderbilt* (1957) 354 U.S. 416, 77 S. Ct. 1360. It is established that the spouses may or may not dispose of their community property relationship in a divorce action. In a divorce case where it is not determined whether there is community property, or in which there is no disposition of the community property, the rights of the spouses continue to remain and they may be litigated in a separate independent action. (*Green v. Green* (1944) 60 Cal. App. 2d 50, 51, 151 P. 2d 679.)

A proper understanding of the community property system in California would therefore seem to meet the "profit-seeking activity" test of the deductibility

of legal expenses advanced by petitioner. In this light the legal expenses were paid for services in and about a quasi-business community property controversy. It has not been suggested that the expenses were not ordinary and necessary.

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**IS THE ORIGIN OF THE DISPUTE CONTROLLING?**

Petitioner's contention that the legal expenses in issue had their origin in marital discord and therefore are personal under Section 24(a)(1) of the 1939 Code and Section 262 of the 1954 Code, is unsound because whatever the personal discord of the spouses may have been, the merits of their controversy over income-producing property was not materially affected by their personal differences. This is brought out by the court in *Lewis v. Commissioner of Internal Revenue,* 253 F. 2d 821, in commenting on *Howard v. Commissioner,* 202 F. 2d 28, which involved the deductibility of the expenses of an army officer in defending himself before a court martial. The court said at page 825,

> "The charges against him, though they had their origin in a marital dispute, were directed to his status as a commissioned officer * * *. The very issue before the tribunal was whether Howard should lose that status and its income concomitants."

That a dispute about property between a husband and wife may have its origin in a divorce and nevertheless be divisible and severable is clearly illustrated

by Treasury Regulations 118, Section 39.24(a)-1 and Section 1.262-1(b)(7) of the Treasury Regulations on Income Tax (1954 Code). The specific Regulations permit the deduction of attorneys' fees even though paid in a divorce or separate maintenance proceeding if properly attributable to the production or collection of amounts includible in gross income under Section 22(k) (alimony) of the 1939 Code and Section 71 of the 1954 Code. In *Bingham's Trust v. Commissioner, supra,* it was held that Section 23(a)(2) established two classes of deductions, (1) ordinary and necessary expenses paid or incurred for the production or collection of income and (2) ordinary and necessary expenses paid or incurred for the management, conservation or maintenance of property held for the production of income. As was stated in *Bingham's Trust v. Commissioner,* they are *in pari materia* with the deductions allowed in Section 23(a)(1), viz., trade or business expenses. It is elementary that things equal to the same thing are equal to each other. It therefore follows that the part of an attorney's fee paid in a divorce or separate maintenance proceeding which is properly attributable to the management, conservation or maintenance of property held for the production of income should be just as deductible as when properly attributable to the production or collection of income.[4]

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[4]The point at which *Lewis v. Commissioner* (2 Cir., 1958) 253 F. 2d 821, departs from the majority of the Circuits and the Court of Claims (*Baer v. Commissioner* (8 Cir., 1952) 196 F. 2d 646; *Bowers v. Commissioner*[3] (6 Cir., 1957) 243 F. 2d 904; *Owens v. Commissioner* (5 Cir., 1959) 273 F. 2d 251; *Patrick v. U. S.* (4

**WERE THE LEGAL EXPENSES PAID TO DEFEND AGAINST A LIABILITY?**

Did Don Gilmore have a liability for the settlement of property? By analogy to *Lykes v. U.S.*, 343 U.S. 118, petitioner asserts erroneously that:

> "The Court of Claims allowed the taxpayer-husband a deduction of 80 percent of the legal expenses he incurred in contesting both the divorce and his liability for the settlement of property." (P.B. 32.)

The court below did not find nor did it hold that there was an issue in the divorce action of any liability of Don Gilmore for the settlement of property. The controversy over community property concerned (1) the extent to which community income was reflected in the increase in value of Don Gilmore's stock and (2) what part, if any, of such increase in value, assuming that it consisted in whole or in part of community, belonged to Dixie Gilmore. Appellee submits that if the court had found in favor of Dixie Gilmore, it would have had to determine how much of the appre-

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Cir., 1961) 288 F. 2d 292, and *McMurtry v. U. S.* (Ct. Cl. 1955) 132 F. Supp. 114) seems to be the weight placed on the origin of the dispute. The court in *Lewis* seems to slant its reasoning toward the view that if the disputed expenses were incurred in a marital dispute, they are not deductible as expenses paid or incurred in the conservation or maintenance of property held for the production of income even though the taxpayer was motivated in paying or incurring such expenses solely because his income-producing property was in jeopardy. The majority view on the other hand seems to be that if the threat against the income-producing property is so great that it endangers the property and the income-producing capacity of the taxpayer, services for the conservation of the property should be regarded as divisible and separate from those rendered in regard to the divorce or legal separation.

ciation in value of the stock was attributable to community income and how Dixie Gilmore was to recover her share. The question was the extent of Dixie Gilmore's rights to or interest in the alleged element of community property and not Don Gilmore's liability to Dixie Gilmore, except insofar as the court might impose some obligation on Don Gilmore to assure the distribution to Dixie Gilmore of the amount of community to which she would be held entitled. The liability would therefore be an obligation to perform a remedy given to assure distribution to Dixie Gilmore. Unlike *Lykes v. U.S.*, supra, the controversy in Gilmore was over alleged specific community property which was attacked directly. In *Lykes*, the controversy concerned the question of indebtedness of a taxpayer for gift taxes; the claimed liability did not concern specific property and no attack was made against specific property held for the production of income.

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**WHETHER THE LEGAL EXPENSES FOUND TO BE DEDUCTIBLE BY THE COURT BELOW SHOULD IN PART BE HELD TO BE CAPITAL EXPENDITURES IN DEFENSE OF TITLE TO PROPERTY.**

Petitioner is completely in error in asserting that part of the expenditures in Gilmore are capital in nature because they were incurred in defense of title to property. There are at least two conclusive answers to this assertion. First, the answer given by the court below (R. 120), viz., that the stocks in question belonged to plaintiff before he was married, after he

was married, and his wife never claimed that he did not hold title to them. (In fact her claim to a community interest in the property depended on his title.) Don Gilmore had clear title to the stock. He could transfer the shares of stock freely.

The statutes and regulations applicable to this question are Section 24 of the 1939 Internal Revenue Code, Section 263 of the 1954 Internal Revenue Code, Treasury Regulations 118, Section 39.24(a)-2, subdivision (a), and Treasury Regulations on Income Tax (1954 Code) Section 1.263(a)-2, subdivision (c).

Section 24 and corresponding Section 263 provide that any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate is a capital expenditure and is not deductible. The applicable regulations under these code sections give as one example, the cost of defending or perfecting title to property. It appears that the statutes and regulations apply only if the cost of defending or perfecting title meets the test of enhancing the value of the property.

Don Gilmore's defense of his stock was not for the purpose of adding anything to its value; the stock was readily transferable and marketable and did not become untransferable or unmarketable because of the claims made by Dixie Gilmore. Nor was any value added to the stock by his successful defense.

Secondly, petitioner's argument that the legal expenses were capital in nature shows a lack of understanding of the community property system. Dixie

Gilmore alleged that the increase in value of the stock was community property because it consisted of earnings resulting from the personal services of Don Gilmore. Under California law community property is property acquired during marriage by the labor or skill of either spouse. *Estate of Arstein* (1961) (Calif.) 56 A.C. 229, 364 P. 2d 33; *Pereira v. Pereira*, 156 Cal. 1, 103 P. 488. Community property is therefore either an accumulation of community income or property purchased or acquired with community income. Therefore, Dixie Gilmore's claim was to unrealized accumulated community income alleged to be included in the increment in value of Don Gilmore's stock. The manner and extent to which Don Gilmore would have to account to Dixie Gilmore for her share of the community income if the court had found that there was community property reflected in the increase in value of the stock was an entirely different matter which the divorce court never reached.

The analysis of petitioner's contention that the legal expenses were capital expenditures also results in the conclusion that Don Gilmore has an alternative ground for deducting the legal expenses in issue. It has been held that legal expenses incurred in any litigation to protect the right of income produced or to prevent others from acquiring a right, title or interest therein is proximately related to the production or collection of income, and such legal expenses are deductible under the "production or collection of income" provision of Section 23(a)(2) of the 1939 Internal Revenue Code. *Falls v. Commissioner* (1946)

7 T.C. 66, following *Estate of Frederick Cecil Bartholomew*, 4 T.C. 349. Therefore insofar as Don Gilmore's legal expenses were incurred in a controversy over accumulated income or gain in value of his stock, they are deductible under Section 23(a)(2). The Treasury Regulations 118, Section 39.23(2)-15, subdivision (b) stated that: "The term 'income' for the purpose of Section 23(a)(2) comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. * * * " The corresponding Treasury Regulations on income tax (1954 Code) Section 1.212-1, subdivision (b) is to the same effect.

Nor do petitioner's authorities sustain the contention that under the facts of the case at bar some of the legal expenses in question should be capitalized. *Harris v. U.S.* (9 Cir.) 275 F. 2d 238, concerned a claim by a wife in a divorce suit that she should be a party to the title of real property which stood in the name of her husband. It does not appear whether the wife's claim was to any increment in value of the real property. Under California law, there is a significant distinction between a claim by a wife that she has a community property interest in real property as compared with a claim of community interest in personal property, as in the case at bar. California Civil Code Section 172a provides that the husband cannot convey community real property alone. His wife must join

with him in executing the deed or any instrument by which the community real property is conveyed. In the case of community personal property, on the other hand, the husband's title permits him to transfer without his wife. Therefore, if a wife contests her husband's title in real property by claiming a community interest therein and the husband wins the contest, he succeeds in perfecting title in himself. Thereafter he can convey the property without his wife's signature.

It should be observed that in *Harris v. U.S.*, supra, at p. 240, the Court of Appeals reaffirmed its approval of the rule in *Baer v. Commissioner*, supra, as shown by the following quotation:

> "In Baer v. Commissioner, * * * the showing was of expense to the taxpayer in resisting a claim which threatened immediate destruction, to a substantial extent, of his capacity to earn income. The legal expense incurred was thought to bear a direct relationship to the management and conservation of property held for the production of income. * * * The Baer case, we think, affords a good illustration of the proper application of the statute."

Doubtless the Court of Appeals would not have treated the legal expense as a capital expenditure if the facts had come within the court's illustration of the proper application of the *Baer* rule.

*Shipp v. Commissioner of Internal Revenue* (9 Cir.) 217 F. 2d 401, is distinguishable from the case at bar. In *Shipp* the legal expenses were incurred in

defense of an action to quiet title to property. The suit was brought by an executor of a deceased wife's estate against the surviving husband praying for a judgment declaring certain assets to be community property and that title to such property should be quieted in the executor. The Tax Court made a finding of fact that the fees were paid in defense of title and were thus capital expenditures. The contest over title in *Shipp* is different from the contest in Gilmore. Dixie Gilmore did not contest Don Gilmore's title to the stock. Even had she succeeded in impressing a community interest on the stock, Don Gilmore would still have held title and the stock would have been freely transferable by him alone, accountable however to Dixie in respect to proceeds of sale. His position would have been that of a constructive trustee for her community interest.

Appellee recognizes that every expenditure to conserve income-producing property has an aspect of a capital expenditure. In the case at bar, any aspect of capital expenditure was purely incidental. The attack made on Don Gilmore's stock consisted of a claim that community income built up the appreciation in value of the stock. The defense by Don Gilmore was against such claim. Any question of title which might ultimately follow, possibly in another law suit, would be incidental. This view is supported by *Rassenfoss v. Commissioner* (7 Cir.) (1946) 158 F. 2d 764, and *Hochschild v. Commissioner* (2 Cir.) 161 F. 2d 817. In *Sergievsky v. McNamara* (1955) 135 Fed. Supp. 233, 238, the court states as follows:

"The mere fact that the plaintiff's Climax shares may have been affected by the Turner action, did not mean that the legal expenditures by plaintiff were directly for the defense of title. Otherwise, every expenditure to conserve income-producing property would be a capital expenditure, thereby emasculating a part of § 23(a)(2). That statute explicitly permits acts to conserve property without necessarily treating such expenses as items of capital cost. Such expenses as were involved in plaintiff's beating off an ill-founded suit did not add to or enhance her property. In deciding such questions, the courts as Judge Learned Hand has said, do not substitute 'juristic metaphysics' and 'theoretic analysis' for more conventional and accepted notions."

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## CONCLUSION

For the foregoing reasons, the judgment of the court below should be affirmed.

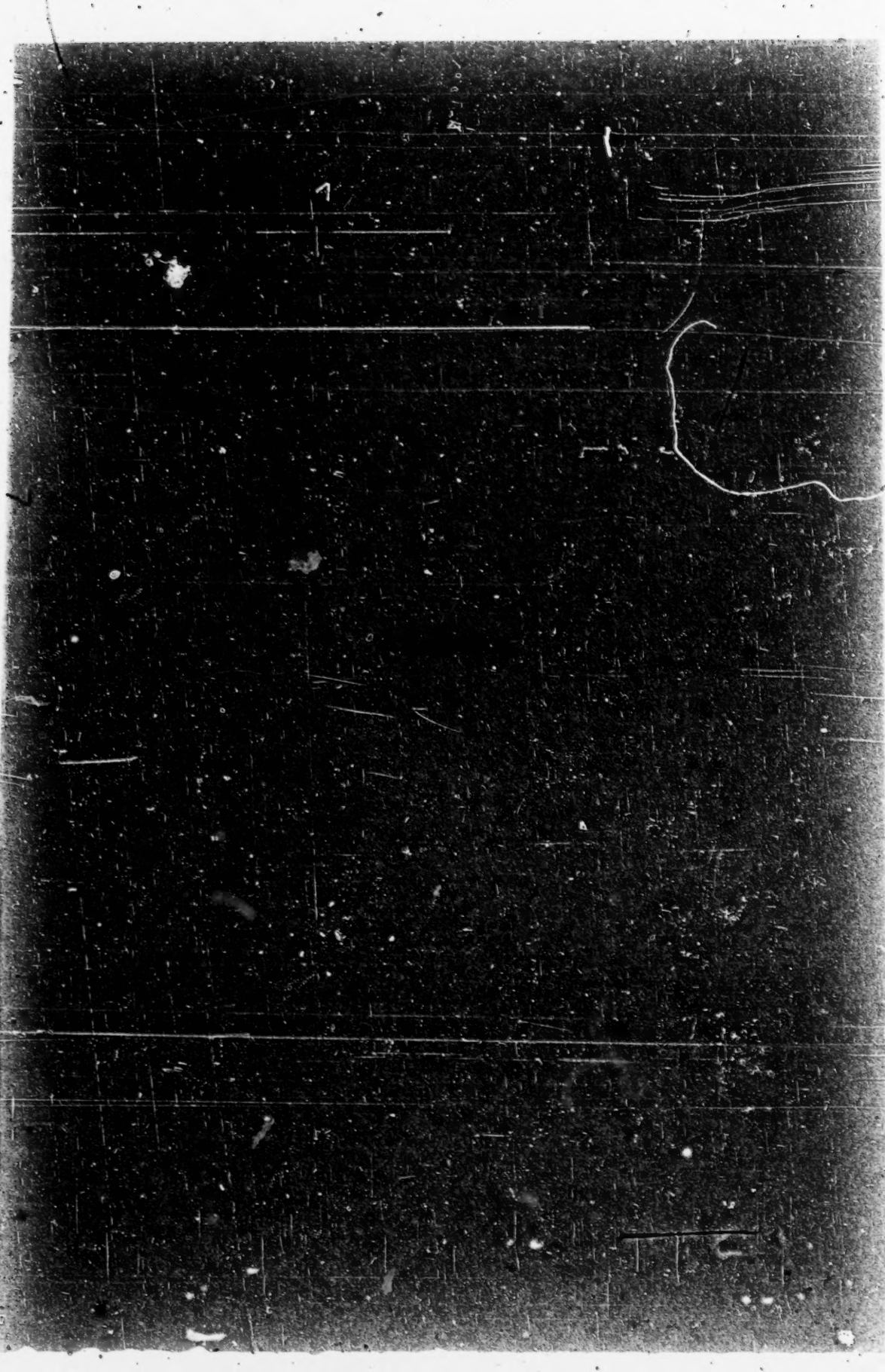
Respectfully submitted,

ELI FREED,

*Attorney for Respondent Don Gilmore.*

February, 1962.

**(Appendix Follows.)**



## Appendix

Treasury Regulations 118:

§ 39.23 (a)-15 Nontrade or nonbusiness expenses.

(a) Subject to the qualifications and limitations in chapter 1 and particularly in section 24, an expense may be deducted under section 23(a) (2) only upon the condition that:

(1) It has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, * * *; and

(2) It is an ordinary and necessary expense for either or both of the purposes stated in subparagraph (1) of this paragraph.

(b) The term "income" for the purpose of section 23(a) (2) comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. * * *

Treasury Regulations on Income Tax (1954 Code)

§1.212-1 Nontrade or nonbusiness expenses.

(a) An expense may be deducted under section 212 only if—

(1) It has been paid or incurred by the taxpayer during the taxable year (i) for the production or col-

lection of income, which, if and when realized, will be required to be included in income for Federal income tax purposes, * * *; and

(2) It is an ordinary and necessary expense for any of the purposes stated in subparagraph (1) of this paragraph.

(b) The term "income" for the purpose of section 212 includes not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. * * *

Internal Revenue Code of 1939 (26 U.S.C. 1953 ed.):

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in [redacted] be allowed in respect of—

* * *

(2) Any [redacted] paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate, * * *.

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 263. CAPITAL EXPENDITURES.

(a) *General Rule.*—No deduction shall be allowed for—

(1) Any amount paid out for new buildings or for permanent improvements or betterments

made to increase the value of any property or estate. [Exceptions]

Treasury Regulations. 118:

SEC. 39.24(a)-2 *Capital expenditures*—(a) * * * The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. * * *

Treasury Regulations on Income Tax (1954 Code):

SEC. 1.263(a)-2. *Examples of capital expenditures.*

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(c) The cost of defending or perfecting title to property.

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# In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 21

UNITED STATES, PETITIONER

*v.*

DON GILMORE AND SUE GILMORE

*ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS*

## BRIEF FOR THE UNITED STATES ON REARGUMENT[1]

### OPINION BELOW

The opinion of the Court of Claims is reported at 290 F. 2d 942.

### JURISDICTION

The judgment of the Court of Claims was entered on June 7, 1961. (R. 112, 125.) The petition for a writ of certiorari was filed on July 25, 1961, and was granted on October 9, 1961. (R. 145, 368 U.S. 816.) The case (No. 255, 1961 Term) was argued on March 27–28, 1962, and by order of April 2, 1962, was restored to the calendar for reargument (369 U.S. 835).

[1] This brief and the separate brief being filed in *United States* v. *Patrick*, No. 22, replace the joint brief filed in the two cases in the 1961 term (Nos. 255 and 256).

The jurisdiction of this Court rests on 28 U.S.C. 1255 (1).

## QUESTION PRESENTED

Whether the following expenses incurred by a husband in divorce litigation qualify as "ordinary and necessary expenses" incurred "for the management, conservation, or maintenance of property held for the production of income" so as to be deductible under § 23(a)(2) of the Internal Revenue Code of 1939, or are nondeductible "personal" or "capital" expenditures:

(1) the expenses of resisting his wife's claim that an income-producing asset was in part community property;

(2) the expenses of resisting his wife's claim that, because of his personal misconduct, she should be given some of his half of the income-producing asset if it was community property; and

(3) the expenses of answering charges of personal misconduct to avoid adverse publicity that might cause harm to his income-producing capacity.

## STATUTES AND REGULATIONS INVOLVED

Sections 23, 24, and 113, Internal Revenue Code of 1939; §§ 162, 212, 262, and 1016, Internal Revenue Code of 1954; § 146 of the California Civil Code; §§ 39.23(a)-15, 39.24(a)-1, and 39.24(a)-2, Treasury Regulations 118 (1939 Code); §§ 1.212-1, 1.262-1, and 1.263(a)-2, Treasury Regulations on Income Tax (1954 Code), are found in the Appendix, *infra*.

## STATEMENT

The respondent[2] and Dixie Gilmore were married in 1946. Six years later, in 1952, they began divorce proceedings against each other in the California courts. At the time of the divorce proceedings, the respondent's property consisted primarily of controlling stock interests (varying from 60% to 100%) in three corporations, each of which was a franchised General Motors automobile dealer.[3] As president and managing officer of the three corporations he received annual salaries totaling $66,800 a year; his dividends had in recent years averaged $83,000; and his total annual income from the corporations was thus approximately $150,000 (R. 128). His income from other sources was negligible (R. 128). Because the divorce proceedings threatened in various ways the respondent's interest in the corporations, his sole source of income, the Court of Claims held that 80% of the costs of conducting the divorce litigation could be deducted as "ordinary and necessary expenses paid or incurred * * * for the management, conservation, or maintenance of property held for the production of income," within the meaning of § 23(a)(2) of the Internal Revenue Code of 1939.

The facts are not in dispute. An analytical statement of them, drawn from the reported decisions in the

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[2] Don Gilmore will be referred to as the sole respondent. His present wife is a party only because a joint return was filed in 1955. Dixie Gilmore, his former wife, and a party to the divorce proceedings, will be referred to as respondent's "wife" notwithstanding the divorce.

[3] Don Gilmore-San Francisco (of which respondent owned 100%) and Don Gilmore-Hayward (73⅓%) were Chevrolet agencies; Don Gilmore-Riverside (60%), a Pontiac agency.

State proceedings (*Gilmore* v. *Gilmore*, 282 P. 2d 598, reversed, 45 Cal. 2d 142, 287 P. 2d 769) as well as from the record, follows.

### A. THE DIVORCE PROCEEDINGS

1. In terms of the judicial relief sought by the parties, there were four major issues in the divorce proceedings:

*First*, to whom the divorce was to be granted. The wife prayed for a divorce on the ground of the respondent's extreme cruelty and adultery. The respondent prayed for a divorce on the ground of her extreme cruelty (R. 132).

*Second*, whether the wife was entitled to alimony. That depended upon whether he or she was awarded the divorce (R. 133, 282 P. 2d at 606).

*Third*, how the community property was to be divided (R. 132). Whichever party was awarded the divorce was entitled to be given more than half and up to all of the community property, as the court "may deem just."[4]

*Fourth*, whether there was any community property. The stock of the corporations was originally the respondent's separate property. During the marriage, however, the corporations had retained out of current earnings some $600,000, increasing their

[4] Cal. Civ. Code § 146, applicable to divorces, as here, based on extreme cruelty or adultery. See *Barham* v. *Barham*, 33 Cal. 2d 416, 202 P. 2d 289; *Wilson* v. *Wilson*, 159 Cal. App. 2d 330, 323 P. 2d 1017.

net worth from $182,010.46 to $786,045.52. The wife contended that those retained earnings were attributable to the respondent's personal services and thus impressed with a community interest, making the stock itself community property to the extent that it represented those retained earnings. Respondent contended that he had been adequately paid for his services and that the earnings retained were attributable rather to the capital assets of the corporations. (R. 130, 131, 133, 134.)

Of the four issues, the first three (divorce, alimony, and division of community property) all turned upon a common fact—which party was the wronged one entitled to the divorce. The fourth issue (the existence of community property) was, in contrast, entirely separate from the rest of the litigation.

2. The trial of the divorce suit took 24 trial days and filled over 3,000 pages of transcript (R. 131). The major part of the protracted trial (about 5/6, measured by the pages of the transcript devoted to the subject) was devoted to proof and disproof of charges and countercharges of adultery, alcoholism,

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[1] See 45 Cal. 2d 142, 149, 287 P. 2d 769, 773-774. In the case of the two corporations not wholly-owned, the figures include only the percentage of the net worth allocable to the respondent's share of the stock. Presumably because of that adjustment, the Court of Claims' findings speak, somewhat imprecisely, of the $600,000 increase as an increase in the "value" of the respondent's "stockholdings." See R. 130 and compare R. 131 (Finding 22). In any event, the record of the state proceedings (part of the record in this case) makes clear that the figures represent changes in the corporations' net worth resulting from increases in their earned surplus accounts. (See Exhibit P-6, pp. 1886-1887.)

abnormal sex acts, physical and verbal abuse, and the like, all of which led the intermediate appellate court to describe the trial as "one of the most sordid and revolting with which" any court had been required to deal. 282 P. 2d 598, 599. A much smaller part of the trial was devoted to the proof of the facts relevant to the existence of community property (adequacy of the salaries paid the respondent; amounts expended by him for community purposes; etc.) (R. 132).

The outcome of the trial was a complete victory for the respondent. His wife was denied a divorce and he was granted one; there was found to be no community property; and an award of $9,000 a year alimony to the wife was vacated on motion of respondent on the ground that the denial of a divorce to her precluded an alimony award. (R. 29–30, 108–109.)

3. On the wife's appeal, the District Court of Appeals reversed the judgment and directed a new trial on the ground that the trial court had given inadequate weight to the respondent's proven adultery as a basis for awarding a divorce also to the wife and thereby permitting an award of alimony. 282 P. 2d 598. On the respondent's appeal to the California Supreme Court, however, that court reinstated the judgment, holding that the trial court did not abuse its discretion in discounting the importance of the respondent's post-complaint adultery. It also affirmed the finding that there was no community property in the stock. 45 Cal. 2d 142; 287 P. 2d 769. The final result of the litigation, therefore, was that the respondent was awarded the divorce and his wife took nothing.

B. THE PROCEEDINGS BELOW

For the costs of the divorce litigation (attorneys' fees, records, printing, etc.), the respondent had spent $32,537 in 1953 and $8,074 in 1954.[6] In a suit for refund brought in due course, the Court of Claims upheld the respondent's claimed deduction of 80% of those expenditures as expenses of "conserving" income-producing property under § 23(a)(2) of the 1939 Code (R. 4–6).[7]

Of the four issues in the divorce proceeding previously outlined, the court treated as nondeductible the expense of the first two (divorce and alimony) and as deductible the expense of the latter two (division and existence of community property) (R. 117–118, 132, 136–137). In addition, the court treated as an additional basis for deduction a fifth non-legal objective found to have been pursued in the divorce proceeding—namely, the purpose, in defending against the charges of scandalous behavior made against him, to minimize the damage to his reputation and the risk that General Motors might cancel his corporations' franchises because of the adverse publicity (R. 118, 132–133). Thus, the court held deductible in principle the expenses attributable to:

> (a) establishing that no part of the stock was community property;

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[6] (R. 134–135). He spent an additional $5,300 in 1955 (R. 114), but that year is not involved here.

[7] The second year involved is governed by the 1954 Code (§ 212(2)), but for simplicity we will refer only to the 1939 Code.

(b) establishing his right, and defeating his wife's, to more than half of whatever community property there was; and

(c) protecting his reputation with General Motors against charges of personal misconduct.

The first of those objects involved a separable part of the litigation and the expenses of accomplishing it could in theory be separately identified. The others, however, were but two consequences that flowed from the same litigation effort—establishing the innocence of the respondent and the guilt of his wife—that also produced the consequences of the divorce being awarded to the respondent and his wife being denied alimony. The problem of allocating a single expenditure (that of litigating the misconduct issues) among four different consequences produced by it was solved by relying upon the testimony of the respondent and his attorneys that the divorce and alimony consequences were not in themselves considered important and that the misconduct issues would not have been so vigorously fought, at so great an expense, but for their impact upon the division of community property and upon the respondent's reputation (R. 118, 130, 133; see R. 25–26, 30, 33–34, 63, 77–80, 86–90). It was on that basis that 80% of the total costs—*i.e.*, not only the separable expenses of disproving the existence of community property but also the major part of the expenses of litigating the misconduct charges—was allocated to the deductible items.

## SUMMARY OF ARGUMENT

We do not challenge the Court of Claims allocation of the expenses and we concede that the sole reason why the respondent incurred the expenses for which

a deduction was allowed was to prevent the loss of his stock and possibly of his job. Our argument is rather that the deductibility of the expense of resisting a financial demand (passing for the moment the community property aspects of the case) turns solely upon the source and nature of the claim and not upon the threatened consequences of its assertion.

## I

A. Section 23(a)(2) allows a deduction for all the "ordinary and necessary expenses paid or incurred * * * for the management, conservation, or maintenance of property held for the production of income." While successfully resisting a monetary liability avoids the need to sell property to raise money to satisfy the liability, the costs of the litigation do not for that reason become expenses of the "conservation" of "property" no matter how literally the statute is read. The statute speaks of conserving "property," not the taxpayer's *interest in* the property, and the use of "conservation" in association with "management" and "maintenance" confirms that "conservation * * * of property" was used in the sense of a physical safeguarding of the thing itself and not in the sense of "conserving" one's "estate" by minimizing one's liabilities. And even if the expenditures did literally fit the wording of § 23(a)(2), they would still be disallowed by § 24(a)(1) if deemed to be "personal" or "family" expenses. Even on the most literal approach to the statute, therefore, it becomes necessary to leave the wording of § 23(a)(2) and search for the underlying distinction between "business" and "personal" expenses.

B. That the dichotomy between "business" and "personal" remains is confirmed by the history of § 23(a)(2). The statute originally allowed deductions only for the expenses of carrying on a "trade or business" (now, § 23(a)(1)). The expenses of other income-producing activities which were held not to constitute a "trade or business"—such as the expense of maintaining a staffed office to handle the taxpayer's investments in securities—were not deductible. Section 23(a)(2) was added specifically to remove the "trade or business" limitation and permit deduction of the expenses of all income-producing activities. The committee reports, as this Court has repeatedly recognized, make plain that that was the sole purpose of § 23(a)(2). Thus, all that § 23(a)(2) establishes for this case is that the expenses of respondent's holding of stock for the production of dividend income are deductible (as they would not have been before § 23(a)(2)). It does not go to the question—the only issue here—whether a particular expenditure qualifies as an expense "of" his stock-holding or, to the contrary, is an expense "of" his marriage or his personal life. In brief, § 23(a)(2) removes the distinction between a "trade or business" and other kinds of income-producing activities—so that the expenses of all kinds of income-producing activities can now conveniently be described as "business" expenses—but it does not remove the distinction between "business" expenses and "personal" expenses.

## II

A. The characterization as "personal" or "business" of the costs of resisting a claim is governed

by the source and nature of the claim and not by the consequences its successful assertion would have. Thus the deductibility of the costs of defending a personal injury suit turns upon whether the accident occurred in the course of business or of personal activities, not upon whether the wealth of the defendant at the time of the suit happens to be invested in income-producing or non-income-producing assets. Since the nature of the assets the defendant holds when sued (and hence those "threatened" by the suit) has nothing to do either with the cause of the suit or the reasons for defending it (there is as much cause to defend whether a store or a home is at stake), it would be wholly capricious to make the nature of the assets then held determinative of the tax consequences, particularly when it is recognized that wealth is readily convertible from one form to another and whether it is in income-producing or non-income-producing form at the date of the trial depends entirely upon the preferences of the defendant.

B. That the source rather than the consequence of the claim controls is, moreover, conclusively established by the decisions of this Court in *Kornhauser* v. *United States,* 276 U.S. 145, and *Lykes* v. *United States,* 343 U.S. 118. In *Kornhauser,* the Court held that defense of a claim arising out of a business transaction was a "business" expense notwithstanding that, at the time of the suit, the defendant was no longer in the business and the claim threatened only non-business property. *Lykes* applied the same principle to the converse situation (that present here), holding that the defense of a claim arising from a

personal transaction (a gift, giving rise to a claim for gift taxes), is a nondeductible "personal" expense notwithstanding that the claim, undefended, would have consumed the taxpayer's income-producing property.

C. Although the lower court decisions relied upon by the Court of Claims, beginning with the Eighth Circuit's decision in *Baer* v. *Commissioner*, 196 F. 2d 646, purport to recognize the basic principle of the *Lykes* case and to create only an "exception" to it, there is no rational basis for the exception. Its scope, so far as its boundaries can be perceived, seems to extend to any case in which, because of the nature of the husband's holdings, the wife's demands threaten the loss not only of his property but also of his job (as by loss of a controlling stock interest). Apart from its lack of any justifying rationale, that "exception"—giving to persons who own substantial blocks of stock in corporations of which they are officers a right to a deduction for divorce litigation costs that is denied to all other taxpayers—is affirmatively offensive in creating the very kind of discrimination among taxpayers that was condemned by this Court in *Lykes*.

## III

The application of those principles to this case is complicated by the circumstance, though not relied upon by the Court of Claims, that the dispute involved claims to community property. As to the bulk of the expenses for which a deduction was allowed, however, that is not a relevant difference, and the

treatment of the small part remaining—turning peculiarly upon the effect to be given to community property concepts—can properly be left for resolution by the Court of Claims on remand.

A. The larger part of the costs for which a deduction was allowed was incurred in the course of litigating, in the divorce court, the parties' charges and countercharges of misconduct of the most intimately personal nature. The theory on which those expenses were allowed was that, while the proof and disproof of misconduct went immediately to determine which party got the divorce and the wife's right to alimony (not claimed as objectives warranting deduction), it also went indirectly, and more importantly, to the disposition of any community property found to exist. Under California law, if a divorce is awarded for adultery or extreme cruelty, the court can give to the innocent spouse so much of the guilty spouse's half of the community property as it deems just. There was thus involved in the litigation (1) the wife's claim to be given some of the respondent's half of the community property because of his mistreatment of her and (2) the respondent's counterclaim, as it were, to be given some of his wife's half because of her mistreatment of him. It was as a cost of defending and prosecuting those claims that the costs of litigating the misconduct charges were held deductible.

The opposing claims for an unequal division of community involved, it is apparent, not "property" rights, but the claim of the innocent spouse to be

given part of the wrongdoing spouse's property as a remedy for a wrong done to his or her person. Those claims are thus no different, in any respect relevant here, from a tort claim for an injury to the person or the inchoate rights of a wife in a common law state to be given a part of the husband's property for her maintenance and support. The claims having their source in the personal conduct of the parties, the expenses of defending or prosecuting them are equally personal and hence nondeductible.

B. The remaining costs for which a deduction was allowed, a small part of the total, were incurred in litigating the *existence* of community property—specifically, in defeating the wife's claim that some part of the stock had become community property because of the alleged retention by the corporations of earnings attributable to the respondent's personal services. Since that dispute involves an assertion of existing "property" rights in specific assets, complicated by the peculiarities of the community-property system, the treatment of that part of the costs raises a variety of problems quite different from those involved in the basic question the case was brought here to resolve. Nor were these questions separately considered by the Court of Claims, which disposed of the whole case rather on the broad grounds discussed above. In the circumstances, should the Court agree with us on the main question and hence as to the necessity of reversing the judgment at least as to the expenses of litigating the misconduct issue, the proper course would be to remand the case to the Courts of Claims to allow that court to consider in the first instance

the proper treatment of the costs specifically attributable to the community-property contest.

## ARGUMENT

### INTRODUCTION

During 1953 and 1954, the respondent expended some $40,600 for attorneys' fees and other costs in divorce litigation with his wife. The Court of Claims allocated 80% of those costs, or $32,500, as the costs of (a) establishing that there was no community property; (b) establishing the respondent's right to more than half of the property, if it was community property; and (c) protecting his reputation against his wife's charges. We do not challenge that allocation and, to make the identification of costs with objects more concrete, are willing to assume that the other issues (marital status and alimony) had somehow been entirely eliminated from the litigation. To remove any remaining factual ambiguities, moreover, we are willing to accept also the following as the facts: that the stock in the three corporations was the only property owned by respondent and hence the only property out of which any award to his wife could be satisfied; that the wife could and would have insisted upon an immediate lump-sum payment of any award to her and that respondent could not have financed the payment by any means other than an outright disposition of the stock (either by giving it in kind to his wife or by selling it to raise the cash); that the disposition of a substantial part of his stock, either to his wife or to third parties, would have caused respondent to lose his position as president of the corporations and might have

caused General Motors to cancel the corporations' franchises; that the scandalous charges made by his wife created a risk that General Motors would cancel the franchises because of the damage to respondent's reputation; and that respondent had no concern for his reputation except as it affected his business interests. The purpose of these concessions is to establish beyond doubt, and we so stipulate, that the sole reason why respondent spent the $32,500 was to keep his stock, his corporations' franchises, and his job.

To the extent, therefore, that the words imply merely a fact, we acknowledge that there was a direct and immediate relationship between the expenses and the retention of income-producing property (the stock) and of an income-producing capacity (the job), for that was indeed the sole reason why the expenses were incurred. The question we propose to argue is not whether that relationship existed (it did) or how "direct" it was (it was direct indeed), but whether that relationship is the legally relevant one. What we will show is that the deductibility of litigation costs turns, not upon the consequences a failure to defeat the claim would have, but upon the origin or nature of the claim itself. We will then show that, looking to the source and nature of the claims asserted by Mrs. Gilmore here, the expenses of resisting them must be characterized primarily as nondeductible "personal" expenses and perhaps in part as capital expenditures.

Although the State litigation in this case actually involved a community-property contest, the Court of Claims' decision does not turn on that circumstance

but applies principles equally applicable to, and in fact derived from cases involving, the costs of resisting a wife's financial demands in a common-law jurisdiction. It was presumably because of the conflicts over those principles, and not the community-property aspects of this case, that certiorari was granted. For that reason and in order to cast the discussion in terms equally applicable to the companion case (*United States* v. *Patrick*, No. 22), which does not involve community property, the argument in Points I and II of this brief will ignore the community property aspect of the case and treat the case, as did the Court of Claims, as though the wife had asserted, not a "property" right, but merely an *in personam* liability of the husband. We will then in Point III consider the problems peculiar to the community-property aspects of the case.

## I.

### A LITERAL READING OF SECTION 23(a)(2) WOULD NOT ENTITLE RESPONDENT TO A DEDUCTION AND THE QUESTION TURNS INSTEAD UPON THE BASIC DICHOTOMY BETWEEN "BUSINESS" AND "PERSONAL" EXPENSES

Section 23(a) of the 1939 Code allows a deduction from gross income for all "the ordinary and necessary expenses paid or incurred":

> (1) * * * in carrying on any trade or business * * *.
>
> (2) * * * for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

Section 24(a)(1) adds the qualification that:

> * * * no deduction shall in any case be allowed in respect of—
>
> (1) Personal living, or family expenses * * *.

Respondent claims that his litigation costs are deductible as an expense of his holding of stock for the production of dividend income. To establish the right to deduction, he must show two things: (1) that stock-holding is an activity the expenses of which are deductible; and (2) that the litigation costs are properly to be treated as an expense "of" that income-producing activity rather than "of" his personal life. When § 23(a)(2) stood alone, respondent could not have met the first requirement, for the mere holding of securities, although an income-producing activity, is not a "trade or business." Section 23(a)(2), however, overcame that obstacle by making the expenses of all income-producing activities, including mere property-holding, deductible whether or not they constitute a "trade or business." We will show that that was all that § 23(a)(2) was meant to do and that it was not intended to create a new and different standard for answering the second question—namely, whether a particular expenditure constitutes an expense of the income-producing activity or of the taxpayer's personal life. In short, we will show that § 23(a)(2) removed the distinction between a technical "trade or business" and other income-producing activities—so that the expenses of

either can now conveniently be described as "business" expenses—but it did not remove the dichotomy between "business" expenses and "personal" expenses or prescribe a new test for drawing the line between them.

This case is concerned, of course, only with the second question. We concede that respondent's stockholding was an income-producing activity the expenses of which are deductible under § 23(a)(2); we contend only that the costs of his divorce litigation were expenses, not of that activity, but of his "personal" or "family" life and hence nondeductible under § 24(a)(1). Since, as the history shows, that is not the issue to which the language of § 23(a)(2) was directed—and since the question requires in any event not merely an application of § 23(a)(2) but an accommodation of that provision with § 24(a)(1)—it seems plain that the question cannot be resolved, as the court below sought to resolve it, by a mere literal application of the wording of § 23(a)(2). Before examining the history of § 23(a)(2) to show its limited purpose, however, it is appropriate to point out that, even if we accept the Court of Claims' premise that the answer to this case is to be found in the words of § 23(a)(2) considered apart from their history and their relationship to § 23(a)(1), the words do not in fact say what the court said they say.

### A. THE COURT OF CLAIMS' DECISION IS WRONG EVEN ON A LITERAL READING OF SECTION 23(a)(2).

The Court of Claims reasoned that, since the purpose of the defense of the suit was to avoid a liability

pose of assets which in turn were income-producing, his litigation costs were literally "incurred * * * for the * * * conservation * * * of property held for the production of income" and hence deductible. Confining ourselves to the words of the statute, we will show that that apparently simple syllogism not only gives to "conservation * * * of property" an unnatural meaning but also quite ignores some other words in the statute, namely, those of § 24(a)(1).

1. The premise of the Court of Claims' reasoning is that a taxpayer's efforts to retain his ownership of property by resisting financial claims that would require him to sell it constitutes "conservation * * * of property." That requires reading "conservation" to mean the same thing as "retention" and "of property" to mean "of the taxpayer's interest in property." Neither of those substitutions is self-evident and the context suggests quite the contrary.

Property and an interest in property are quite different things, and § 23(a)(2) literally refers only to "property." Its full text, moreover, seems unavoidably to refer to operations ("management, conservation, or maintenance") performed with respect to the thing itself, the res, rather than the owner's interest in the res. Surely, for example, the expenses of renting ("managing") or repairing ("maintaining") real property held for rental purposes are within § 23(a)(2), and in that usage the thing being managed or maintained is the house itself, not the taxpayer's title to it. Thus, unless the single word "property" was used with an uncomfortable double meaning—a contention ill made by a literalist—the

expenses of protecting one's *ownership* of property (against the need to sell it to raise money to meet a financial demand) cannot be within § 23(a)(2).

The same result follows if the word "conservation" is examined. "Conservation" is defined in Webster's New International Dictionary (2d ed.) to mean:

> 1. A conserving, preserving, guarding, or protecting; a keeping in a safe or entire state; preservation.

The verb is in turn defined:

> 1. To keep in a safe or sound state; to save; to preserve from change or destruction.

As thus defined, "conservation" implies a physical safeguarding of the thing, or the prevention of change in its state. And it is in that sense that "conservation" is used in § 23(a)(2) to make deductible the cost of a night watchman to guard rental property or the fee paid for a safe deposit box in which to keep securities. To use "conservation" as including also the avoidance of the need to sell an interest in the thing to satisfy a liability not only seems a rather remarkable usage but it again requires that a single word be made to do double service.

Finally, an expense incurred for the "conservation * * * of property held for the production of income" seems to us to imply an expenditure having a direct relationship to a specific piece of property. It may be acceptable usage to refer to minimization of one's expenditures or liabilities as "conserving" one's *estate*—meaning by that his total wealth—but we deny that it is common usage to identify avoidance or minimization of general liabilities as an act of "conserv-

ing" any specific "property" held by the taxpayer, for the production of income or otherwise.

2. Secondly, a literal reading of the statute cannot stop with § 23(a)(2) but must deal with § 24(a)(1) as well. Section 24(a)(1) provides that no deduction shall "in any case" be allowed for "personal, living, or family expenses," and that literally includes the case of an expenditure otherwise literally within § 23(a)(2). Thus, if an expense of resisting a wife's assertion of rights arising from the marriage relationship were properly to be characterized (because of the origin of the claim) as a "personal" or "family" expense within the meaning of § 24(a)(1), the expense would be nondeductible even if it also qualified (because of the threatened consequences of the claim) as one incurred for the "conservation" of income-producing property within the meaning of § 23(a)(2). Even one who seeks to answer the question by a literal reading of the statute is thus ultimately forced back to defining, without further statutory aid, the word "personal" and saying what it is that distinguishes the "personal" from the "business."

3. A final objection to the Court of Claims' reading derives from its implications if applied with the same literalness in other contexts. The court reads "incurred * * * for" as referring to the consequences to be achieved by the expense: an expense is "for" conservation if making it will *result* in conservation. But what if the conservation is the cause of the expense rather than *vice versa?* An example might be the defense of a suit by a tenant for the assault and battery of a night watchman who mistook him for a

burglar.[8] The night watchman was hired for the conservation of the property, and it was his activities to that end that gave rise to the suit, but defending the suit will not itself "conserve" anything except the defendant's money. The defense costs, in short, are literally not incurred "for" the conservation of the property but only "because of" prior conservation activities. Under the Court of Claims' literal reading, therefore, they would not be deductible. It was just that sort of literalism, however, that this Court rejected long ago in *Kornhauser* v. *United States*, 276 U.S. 145, in interpreting the counterpart language of § 23(a)(1), "incurred * * * in carrying on" a trade or business. There it was argued that the expense of defending a suit arising out of a business activity could not be deducted because the defendant, at the time of suit, was no longer "in" the business giving rise to the suit and the defense costs could not, therefore, have been incurred "in carrying on" the business. This Court rightly paid no heed to the argument and held that the defense costs were to be treated as a cost of the activities from which the suit resulted. The "for" of § 23(a)(2), we submit, is no more the answer to the question in this case than was the "in" of § 23(a)(1) in the *Kornhauser* case.

This last objection, it may be seen, goes less to the particular interpretation adopted by the Court of Claims than to the attempt to give the statute such a literal interpretation at all. The language "incurred

[8] A more likely example, of course, is that of a suit for injuries resulting from a defect in the premises, but we have chosen the night watchman case to stay within the "conservation" category.

* * * for the management, conservation, or maintenance of" (§ 23(a)(2)) is no more precise or self-explanatory than the phrase "incurred * * * in carrying on" (§ 23(a)(1)), and it must ultimately be recognized that neither is anything more than an attempt to convey the notion of an expense being an expense "of" the income-producing activity. To seek more help than that from the bare language of the statute is fruitless.

B. SECTIONS 23(a)(1) AND 23(a)(2) ARE IN PARI MATERIA AND TOGETHER SERVE THE SINGLE FUNCTION OF PERMITTING DEDUCTION OF "BUSINESS" AS DISTINGUISHED FROM "PERSONAL" EXPENSES

1. Prior to 1942, the only general provision authorizing the deduction of the expenses of income-producing activities was the forerunner of § 23(a)(1), which allowed deduction only of expenses incurred in carrying on "any trade or business." Giving that provision a narrow construction, the Treasury contended that only certain kinds of profit-seeking activities constituted engaging in a "trade or business" and that there was no authority for the deduction of the expenses of other kinds of profit-seeking activities. That interpretation was ultimately upheld by this Court in a series of three decisions announced in 1941. In *Higgins* v. *Commissioner*, 312 U.S. 212, the Court, noting that not "every business transaction" constituted "carrying on" a "trade or business" (p. 217), held that the activities of an individual in overseeing his extensive investments in stocks and bonds did not constitute a "trade or business" in the statutory sense and hence that his expenses of maintaining a staffed

office to handle his investments were not deductible. The same result was reached in *City Bank Co.* v. *Helvering*, 313 U.S. 121, in denying a trust a deduction for the fee paid a trustee for its services in managing the trust fund, and in *United States* v. *Pyne*, 313 U.S. 127, as to a decedent's estate.

In the Revenue Act of 1942 (56 Stat. 798, § 121), Congress promptly responded to the "inequity" thus revealed—*i.e.*, of denying a deduction for the expenses of profit-seeking activities the income from which was taxed [9]—by adding § 23(a)(2), allowing deduction of the expenses of all income-producing activities regardless of whether the activity constitutes a technical "trade or business." The committee reports make clear that the sole purpose of the amendment was to remove the "trade or business" limitation on the kinds of profit-seeking activities the expenses of which could be deducted: [10]

> A deduction under this section is subject, except for the requirement of being incurred in connection with a trade or business, to all the restrictions and limitations that apply in the case of the deduction under section 23(a)(1)(A) of an expense paid or incurred in carrying on any trade or business. * * *

That is to say, § 23(a)(2) was directed solely to the kinds of activities the expenses of which are deductible and not at all to the tests for determining whether an expenditure is an expense "of" the activity. Or, to put it another way, § 23(a)(2) removed

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[9] H. Rep. 2333, 77th Cong., 2d Sess., p. 46.

[10] H. Rep. 2333, 77th Cong., 2d Sess., p. 75; S. Rep. 1631, 77th Cong., 2d Sess., p. 88

the distinction between a "trade or business" and other kinds of income-producing activities, but it did not affect the distinction between "business" expenses (though now including those of all income-producing activities, not just of a "trade or business") and "personal" expenses. When the question is, as here, whether a claimed deduction is an expense of an income-producing activity or an expense of one's personal life, the question is the same whether the deduction is claimed under § 23(a)(1) or under § 23(a)(2).

2. The limited function of § 23(a)(2) and its relationship to § 23(a)(1) was confirmed by this Court upon its review of the history of that provision in *McDonald* v. *Commissioner*, 323 U.S. 57; *Trust of Bingham* v. *Commissioner*, 325 U.S. 365; and *Lykes* v. *United States*, 343 U.S. 118. The new provision, the Court said, was "comparable and *in pari materia* with § 23(a)(1)," providing for a class of deductions "coextensive with the business deductions allowed by § 23(a)(1), except for" the requirement that the income-producing activity qualify as a "trade or business." *Trust of Bingham, supra*, at pp. 373, 374. The purpose was to overcome the specific inequity brought to light by the *Higgins* case by enlarging "the category of incomes with reference to which expenses were deductible," but not to "enlarge the range of allowable deductions of 'business' expenses"; accordingly, if an expense was previously nondeductible, not because the income-producing activity failed to qualify as a "trade or business," but because the relationship of the expenditure to the activity was insufficient to qualify it as an expense "of" the activity, § 23(a)(2) did not

make it any more deductible. *McDonald*, *supra*, at pp. 61–62.

3. Not only do history and authority require that §§ 23(a)(1) and 23(a)(2) be given the same effect in that respect—*i.e.*, in defining the required relationship between the expense and the income-producing activity—but any other view would produce a capricious discrimination between taxpayers engaged in a "trade or business" and those engaged in other kinds of income-producing activities.

Whether § 23(a)(1) or § 23(a)(2) is technically applicable to a given case depends solely upon whether the income-producing activity involved constitutes a "trade or business" or not. In our view of the two provisions, it makes no difference which is applicable, and the distinction between a technical "trade or business" and other income-producing activities is thus effectively obliterated. Under the Court of Claims' view the distinction remains, only it is turned topsy-turvy: the fact that an income-producing activity qualifies as a "trade or business" may make an expenditure *less* deductible than if it were not a "trade or business."

That consequence may be demonstrated by supposing that in this case the respondent had conducted his dealerships as a sole proprietorship rather than in a corporate form. That would not have changed the seriousness of the threat to his income-producing assets from his wife's suit nor the causal relationship of the expense of defending the suit to the ultimate production of income. Under the Court of Claims' view, however, it would drastically change the result,

for, since a sole proprietorship is a "trade or business," the case would now be governed by § 23(a)(1) rather than § 23(a)(2). Thus the language the court found dispositive of the actual case—"incurred * * * for the management, conservation, or maintenance of" income-producing property—would no longer be controlling but would be replaced with the rather less congenial language, "incurred * * * in carrying on" a trade or business. One must assume that, since the Court of Claims found the particular wording of § 23(a)(2) so essential to its result, it would be forced to reach a different result under § 23(a)(1) and would hold that the divorce litigation costs were not deductible, not being literally an expense incurred "in carrying on" the business. In short, the deductibility of the expenses of resisting a wife's financial demands turns, in the Court of Claims' view, upon whether the husband's business is incorporated or not. And while that is anomalous enough, it is made even more anomalous by the fact that the discrimination is in favor of those whose income-producing activities *fail* to qualify as a "trade or business." The former victims of discrimination (under *Higgins*) are now to be a favored class, and all in the name of a statute expressly designed to eliminate such unjust discriminations.

That discrimination inheres, it may be seen, in any construction of the statute that relies upon the language of § 23(a)(2) ("incurred * * * for the management, conservation, or maintenance of" income-producing property) as being in some way less restrictive in scope than the corresponding language of § 23(a)(1) ("incurred * * * in carrying on" a trade or busi-

ness). It can be avoided only by recognizing that, as the history teaches, the difference in wording is attributable only to the different kinds of income-producing *activities* being described in the two provisions and was not meant to prescribe a different test for determining whether an expenditure is an expense *of* a given income-producing activity.

We have shown in this Point that the sole purpose and effect of § 23(a)(2) was to eliminate the distinction, for deduction-purposes, between a "trade or business," in the technical sense, and other income-producing activities. With the distinction between kinds of income-producing activities eliminated, §§ 23(a)(1) and 23(a)(2) can together appropriately be described as authorizing the deduction simply of all "business expenses"—*i.e.*, using "business" in a broad sense encompassing all income-producing activities, the only sense, indeed, in which it is any longer useful.[11] The

[11] The caption given to § 23(a)(2) in the Code—"Non-trade or non-business expenses"—while historically understandable, is a classic misnomer. Of the universe of expenses, the only thing it excludes is "trade or business" expenses which, being equally deductible, is the one category that it is totally unimportant to differentiate. The Code's caption, that is, serves only to distinguish § 23(a)(2) from § 23(a)(1), not from "personal" expenses or other kinds of nondeductible expenditures. Section 23(a)(2) expenses can usefully be called "non-business" expenses only if one is interested for some reason in distinguishing between the expenses of a "trade or business" in the technical sense and those of other income-producing activities, a distinction which, though the historical explanation for the usage, is no longer relevant to deductibility. For every

identity of function between §§ 23(a)(1) and 23(a)(2) means, in turn, that the question in this case turns, not upon any difference of wording between those two provisions, but upon the basic dichotomy between those two provisions ("business" expenses), on the one hand, and § 24(a)(1) ("personal" expenses), on the other.[12] The question, to which we now turn, is simply: what aspect of a litigation expense governs its characterization as "business" or "personal"?

## II

### THE CHARACTERIZATION AS "PERSONAL" OR "BUSINESS" OF THE COSTS OF RESISTING A CLAIM IS GOVERNED BY THE SOURCE OF THE CLAIM AND NOT BY THE CONSEQUENCES A FAILURE TO DEFEAT IT WOULD HAVE

The critical question in this case is whether the characterization as "business" or "personal" of the expenses of resisting or compromising a claim turns upon (a) the origin and nature of the claim (*i. e.*, whether the claim arises from business or personal

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other purpose—in particular, the distinction between the expenses of income production and those of one's personal life with which we are concerned here—expenses deductible under § 23(a)(1) and those deductible under § 23(a)(2) can be lumped together as a single class of "business" expenses.

[12] As we have previously suggested (p. 22, *supra*), one can arrive at the same result by saying that, whatever the initial scope of § 23(a)(2) read alone might be, § 24(a)(1) nevertheless carves it down by expressly disallowing "personal" expenses, thus making the applicability of the "personal" characterization the controlling question in any event. Sections 23(a) and 24(a)(1) are not, however, antagonistic in purpose and the same result should be reached whichever is the starting point. Rather than viewing § 23(a) as granting a deduction and § 24(a)(1) as taking it back, they should be viewed as complementary provisions and given a consistent construction.

activities) or (b) the consequences or effect a failure to defeat it would have (*i.e.*, whether an adverse judgment would expend itself upon business or personal assets). The court below, following *Baer* v. *Commissioner*, 196 F. 2d 646 (C.A. 8), and its progeny, held the consequences determinative and allowed the deduction because the wife's claims, if successful, would have caused the loss of part of respondent's stock and perhaps of his job. In our view, supported in the specific context of divorce litigation by the conflicting decision of the Second Circuit in *Lewis* v. *Commissioner*, 253 F. 2d 821, it is the nature and source of the claim that controls, and the costs of resisting asserted marital rights are thus a cost of the marriage from which the claim arose and not of the business upon the assets of which the claim, if successful, would expend itself. The issue, in short, is neither more nor less than the validity of the long-standing regulation that:

> An expense (not otherwise deductible) paid or incurred by an individual in determining or contesting a liability asserted against him does not become deductible by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability.[13]

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[13] Regs. (1954 Code), § 1.212-1(m); see Regs. 118 (1939 Code), § 39.23(a)-15(k). In a sense, the validity of the specific regulation which disallows deductions for legal fees incurred in connection with divorce proceedings (see p. 45, n. 21, *infra*) is more directly at issue, but it is the general provision quoted in the text that establishes the fundamental principle of which the divorce-costs regulation is but a specific application.

We will show (1) that the rationale of the court below is indefensible in reason; (2) that it has in any event been definitively rejected by this Court; and (3) that in fact even the lower court decisions are uniform in support of the basic principle, having departed from each other only in the creation of a demonstrably untenable "exception".

A. MAKING THE DEDUCTIBILITY OF THE COSTS OF RESISTING A CLAIM TURN UPON THE NATURE OF THE ASSETS THREATENED BY THE CLAIM PRODUCES CAPRICIOUS AND IRRATIONAL RESULTS

The implications of the contending principles can be most conveniently illustrated in the context of tort litigation, where the elements of source and consequence can be most easily varied. If a taxpayer is sued, say, for $200,000 in damages for personal injuries caused in an automobile accident, the deductibility of the defense costs turns, we contend, upon whether the accident occurred in the course of a business activity (*e.g.*, while an employee was making deliveries) or a personal one (*e.g.*, a vacation trip). To make it turn, to the contrary, upon the nature of the assets the defendant owns (and thus would have to sell to pay an adverse judgment) is, we submit, wholly capricious.

1. The first objection to making the defense costs of such a suit turn upon the nature of the assets threatened by it is that the income-producing or non-income-producing nature of the assets that would be consumed by an adverse judgment simply has no causal or other rational connection either with the cause of the suit or the reasons for defending it. It is true enough that if the defendant owns nothing but a cor-

ner grocery store, a $200,000 tort suit will threaten the very existence of his business. But that fact will give him no more cause to resist the claim than if he owned nothing but a home: $200,000 is $200,000, and it is equally worth fighting to keep whatever the form in which it is invested (a home or a store). It is evident, indeed, that since assets are readily convertible from one form to another, the form in which they are held at any given time—in particular, at the time of suit—is essentially fortuitous and dependent on factors having nothing to do with the suit. Making deductibility of the defense costs turn upon the form of investment at the time of suit would mean, for example, that a home-owning defendant could become entitled to deduct the costs of defending the tort suit by mortgaging his home and investing the proceeds in government bonds before the trial began. His defense of the suit would then, in the court's terms, be for the "conservation" of income-producing property (the interest-bearing bonds) which, after being "conserved" by the successful defense of the suit, could then presumably be used to discharge the mortgage on his home. The non-sense of a rule turning upon such irrelevancies is evident. If two taxpayers have accidents while on their vacations and are sued for personal injuries, they ought both or neither be allowed to deduct the costs of defending the actions; it is offensive to reason to allow one to deduct the costs because he happens to be a store owner or a stockholder and deny a deduction to the other because his capital happens at the time to be invested in a home. Whether the property that may have to be used to satisfy the

liability happens to be income-producing or not has nothing to do with either the accident giving rise to the claim or to the taxpayer's reasons for defending it (to preserve his *assets*, whatever they may be). It should have no more to do with the tax consequences of the claim and its defense.

2. Like most tax questions, which aspect of an expense governs its characterization as "personal" or "business" cuts both ways. If the Court of Claims treats as "business" the expense of defending a suit threatening business assets, it must also, to be consistent, treat as "personal" a suit threatening only personal assets. Deduction of the cost of defending a suit for injuries caused by an employee while making deliveries would thus, for example, have to be denied if, by the time the case was tried, the defendant had sold the business, purchased a home, and retired. Since the judgment could be executed only upon the home, the expense of resisting it would be incurred for the "conservation", not of income-producing assets, but only of personal assets."

Nor can that corollary be avoided by saying that the expense is "business" if related to business *either* in origin or consequence. Not only would that require the court to abandon its "literal" reading of § 23(a)(2)—the only justification offered for the rule in the first place—but there is no warrant for giving such two-edged preference to the allowance of "business"

"To make the language of § 23(a)(2) literally applicable in this context, if that be thought important, we need only make the suit one for injuries caused by the alleged negligence of an employee hired to paint rental property which, at the time of suit, is no longer owned by the taxpayer.

expenses over the equally explicit—and literally overriding—disallowance of "personal" expenses (§24(a)(1)). The same aspect of the claim must control the characterization for both purposes, and if the fact that "business" assets are threatened makes the defense "business", the fact that "personal" assets are threatened must make the defense "personal". Taxpayers cannot have it both ways.

Once the implications of the question for the converse situation (a claim business in origin and personal in threatened consequence) are recognized, it becomes evident that one must look to the nature and source of the claim to determine for tax purposes the "business" or "personal" character of the costs of defending it. If a claim arises from a business transaction, the cost of defending it is a cost of business and deductible; if from a personal activity, it is a cost of the personal activity and nondeductible; in neither case is the content of the defendant's portfolio at the time of suit relevant.

B. THE QUESTION HAS BEEN AUTHORITATIVELY RESOLVED BY THE DECISIONS OF THIS COURT

In numerous decisions the Court has in general language emphasized the requirement of deductibility that the expense *arise out of* or be incurred *in* the profit-seeking activity. Thus, an expense which "is directly connected with or proximately results from the conduct of"—or is an "integral part of carrying out" an income-producing activity is deductible (*Trust of Bingham* v. *Commissioner*, 325 U.S. 365, 374, 375 (expense of winding up trust)), while an expense "not incurred in 'carrying on' his 'business'" is not (*Mc-*

*Donald* v. *Commissioner*, 323 U.S. 57, 62 (expenses of campaign for re-election as judge)). And in terms of an expense incurred in satisfying an obligation (though not a litigation expense), the Court has specifically noted that "it is the origin of the liability out of which the expense accrues" or "the kind of transaction out of which the obligation arose * * * which * * * [is] crucial and controlling." *Deputy* v. *du Pont*, 308 U.S. 488, 494, 496.

We need not, however, rely upon the implications to be drawn from such general language, for there are two decisions of the Court, dealing specifically with litigation costs, that are in our view directly controlling: *Kornhauser* v. *United States*, 276 U.S. 145, and *Lykes* v. *United States*, 343 U.S. 118.[15] Those two cases, dealing with both of the converse situations—a claim business in origin and personal in consequence (*Kornhauser*) and one personal in origin and business in consequence (*Lykes*) establish beyond dispute that, whichever way it cuts, it is the origin rather than the consequence of the claim that controls.

1. In *Kornhauser*, the taxpayer's former law partner brought suit against him for an accounting, alleging that certain fees that had been paid to the taxpayer (in the form of stock) were for services performed during the existence of the partnership and should be divided with him. The taxpayer, having successfully defended the suit on the ground that the

[15] *Commissioner* v. *Heininger*, 320 U.S. 467, also dealt with litigation costs. There, however, the litigation both *arose from* and *threatened* the taxpayer's business, so that the distinction considered here was not involved.

fees were paid for services performed after termination of the partnership, sought to deduct the expense of the litigation. In reasoning precisely paralleling that of the Court of Claims in this case, the then Bureau of Internal Revenue argued that since the taxpayer was no longer a partner the expense was not incurred "in carrying on" a business in which he was then engaged but was simply a personal or capital expense designed to protect the taxpayer's personal property from the plaintiff's claim. Reviewing prior rulings holding deductible the expenses of defending, for example, medical malpractice suits, patent infringement suits, and suits for injuries caused by employees, the Court drew from them the principle that "where a suit or action against a taxpayer is directly connected with, or * * * proximately resulted from, his business, the expense incurred is a business expense." Agreeing that the principle was sound and "covers the present case," the Court held the litigation costs to be a "business" and not a "personal" expense (276 U.S. at 153). What *Kornhauser* holds in express terms, we submit, is that it is the nature of the activity from which the "suit or action * * * resulted," not the prospective effect of an adverse judgment, that fixes the tax character of the costs of defending it.

2. The *Kornhauser* case, involving the converse situation (business claim threatening personal assets), may be persuasive only in principle, but the *Lykes* case provides a direct holding on the very question of critical importance in this case: whether the defense of a claim arising from a personal transaction becomes

a "business" expense merely because the liability, if sustained, will have to be met out of income-producing assets.

Mr. Lykes was the president of a closely-held family corporation. From his 3,000 shares of stock, he made gifts totalling 1,000 shares to his wife and children, paying a gift tax on the transfers at a stated value. The Commissioner found the taxpayer's valuation of the stock much too low and asserted a gift tax deficiency of $145,000. Litigation of the value was ultimately settled by the payment of $15,600 in additional taxes. Mr. Lykes claimed a deduction under § 23(a)(2) for the expenses of the litigation. He argued, *inter alia*, that had the original deficiency been upheld he would have had to liquidate his remaining stockholdings, his primary source of income, in order to pay it and that, accordingly, the expense of defending the claim was an expense of conserving and maintaining his income-producing property. Noting first that the deductibility of legal fees "turns wholly upon the nature of the activities to which they relate" and that the gifts which gave rise to the claim were personal rather than income-producing transactions (343 U.S. at 123), the Court went on to reject the taxpayer's argument in terms equally dispositive of this case (343 U.S. at 125–126):

> Legal expenses do not become deductible merely because they are paid for services which relieve a taxpayer of liability. That argument would carry us too far. It would mean that the expense of defending almost any claim would be deductible by a taxpayer on the ground that such defense was made to help him keep clear of

liens whatever income-producing property he might have. For example, it suggests that the expense of defending an action based upon personal injuries caused by a taxpayer's negligence while driving an automobile for pleasure should be deductible. Section 23(a)(2) has never been so interpreted by us. * * *

While the threatened deficiency assessment of nearly $156,000 added urgency to petitioner's resistance of it, neither its size nor its urgency determined its character. It related to the tax payable on petitioner's gifts * * *. The expense of contesting the amount of the deficiency was thus at all times attributable to the gifts, as such, and accordingly was not deductible.

If, as suggested, the relative size of each claim, in proportion to the income-producing resources of a defendant were to be a touchstone of the deductibility of the expense of resisting the claim, substantial uncertainty and inequity would inhere in the rule. * * * It is not a ground for defense [deduction?] that the claim, if justified, will consume income-producing property of the defendant. * * *.[16]

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[16] Expenses of contesting tax liabilities—the fact situation directly involved in *Lykes*—are now deductible under § 212(3) of the 1954 Code. That provision, new to the 1954 Code, reflects simply a policy judgment, of obvious appeal, that the expenses of litigating with one's government over tax liabilities ought to be deductible notwithstanding their "personal" character, and is of a piece with, for example, the deduction allowed for extraordinary medical expenses. It in no way detracts from the basic holding of the *Lykes* case that, for purposes of determining deductibility as a "business" expense (§ 23(a)(1) or (2)), the source of the liability rather than the nature of the assets threatened is determinative.

It would be difficult to choose language more explicitly rejecting the theory on which the decision below is expressly based—that the cost of defending a claim becomes a deductible cost of "conserving" income-producing property if the claim, undefended, would consume income-producing property. The decision of the Court of Claims can stand only if this Court overrules its *Lykes* decision and, in the process, the application of the same principle to the converse situation in *Kornhauser*.

C. THE LOWER COURT DECISIONS SUPPORT THE BASIC PRINCIPLE AND THE "EXCEPTION," SOME HAVE RECOGNIZED IS PREMISED UPON AN UNTENABLE DISTINCTION

If a husband owning diversified securities is sued by his wife for a divorce, the expenses incurred by him to resist or compromise her claims to alimony or a property settlement are not deductible notwithstanding that the wife's claims would require him to dispose of a substantial part of his portfolio of securities—*i.e.*, of his income-producing property. To that proposition there is no dissent to be found in any of the lower-court decisions. The Board of Tax Appeals so held as early as 1926;[11] the regulations

[11] *Joyce* v. *Commissioner*, 3 B.T.A. 393; *Robins* v. *Commissioner*, 8 B.T.A. 523. For an early court of appeals case accepting without question the principle that the defense is personal if the dispute arose from personal transactions (and thus examining only the question whether the dispute in fact arose from the spouses' business affairs or, as the court concluded, their domestic affairs), see *Sanderson* v. *Burnet*, 63 F. 2d 268 (C.A.D.C.).

While these cases arose before the addition of §23(a)(2) (in 1942), the same argument could be, and was, made before then on the premise that the assets threatened were assets

have so provided since 1934 (see note 21, p. 45, *infra*); and every case dealing with the deductibility of fees incurred in divorce litigation has expressly acknowledged that to be the rule. What the dispute in the lower courts is about—and all that it is about—is whether there is an "exception" to the rule.

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used in the "trade or business." That the management of a portfolio of securities was not a "trade or business" was not definitely resolved, it should be remembered, until the *Higgins* decision in 1941 (see pp. 24-25, *supra*). Thus in the formative *Loges* decision, *supra*, the Board assumed that the husband's management of his estate (stocks and bonds) was a "trade or business" and disposed of the claim in terms equally applicable to § 23(a)(2). Answering an argument that since his wife's attempt in divorce proceedings to set aside a postnuptial property agreement and obtain a larger award of property threatened his "business" assets, the expense of compromising her claims was a business expense, the Board, in language foreshadowing the *Lykes* decision (under § 23(a)(2)) by some 26 years, said (p. 397):

> * * * his purpose in entering into the [postnuptial] agreement, or in resisting the attacks upon it [*i.e.*, to preserve his estate], is not determinative of the nature of the expense. Any kind of liability to which he might have been subjected, however remote from the carrying on of his business, would have the same results to his estate. The taxpayer's argument ignores the genesis of the rights which he attempted to settle and limit by the postnuptial agreement. Whatever rights the wife had arose out of the marriage relationship, and her claims subsequent to the postnuptial agreement were certainly of the same origin. It is this fact which must determine the nature of the expense of opposing or adjusting those claims. * * *

Looking thus to the "genesis" of the rights asserted, the Board concluded that, marriage being a personal relationship, the "legal rights and obligations annexed to the relationship are also personal, and the expenses connected therewith" are thus "personal or family expenses" which are expressly made non-deductible (*ibid.*).

1. The birth of the claimed exception came in 1952 with the decision of the Eighth Circuit in *Baer* v. *Commissioner*, 196 F. 2d 646. Mr. Baer was the president of a corporation in which he owned a substantial amount of stock. His wife, suing for divorce, demanded, in satisfaction of her rights to alimony, a lump-sum payment so large that, to make it, Mr. Baer would have had to sell a considerable part of his stock, jeopardizing his control of the company and thus his position as president. Negotiations produced an agreement giving the wife, in addition to a small cash payment, the right to fixed monthly payments for the rest of her life. The agreement recited that the wife had agreed "to modify and reduce" her demands in consideration of the agreement to pay alimony regardless of remarriage. The total value of the settlement was in fact less than half the amount originally demanded.[18] Mr. Baer claimed a deduction for the part of his attorneys' fees which were for services in negotiating "the form and amount" of alimony. The Eighth Circuit, reversing the Tax Court and with Judge Woodrough dissenting, held the fees deductible under §23(a)(2). Since Mr. Baer had conceded at the outset that Mrs. Baer was entitled to "a very large sum in alimony" (though not, of course, as large as she demanded), "The controversy did not go to the question of the liability but to the manner in which

[18] The wife had demanded one-sixth of Mr. Baer's $6–$8 million estate, or something over $1 million. She got $17,500 a year for life—worth, say, $350,000 (an amount which, if invested at 5% would produce $17,500 in perpetuity)—plus $35,000 in cash and some stock worth about $50,000 (see 16 T.C. 1418).

it might be met", without causing Mr. Baer "to relinquish control of the source of his income" (pp. 649–650, 651). "[H]ence," the court said, the services were "for the purpose of conserving and maintaining this income-producing property" (p. 651).

The *Baer* case has been followed, in dictum or in holding, by the Court of Claims and the Fourth, Fifth, Sixth and Ninth Circuits.[19] Generally, their opinions have simply relied upon *Baer* as authority without adding to its reasoning, but they have to some extent clarified the boundaries of the "exception." Although the language of *Baer* distinguishing the questions of "liability" and of "manner [of payment]" is occasionally recited, most courts seem to recognize that it is a spurious distinction, since the controversy is never simply over the "manner" of payment (as it was not in *Baer*) and a dispute over the amount of liability is hardly meaningfully different from one over the fact of liability. The recognized exception seems rather to be defined solely by the threatened impact of the

[19] For holdings see, besides this case from the Court of Claims and the companion *Patrick* case (No. 22) from the Fourth Circuit: *Bowers* v. *Commissioner*, 243 F. 2d 904 (C.A. 6); *Owens* v. *Commissioner*, 273 F. 2d 251 (C.A. 5); and *McMurtry* v. *United States*, 132 F. Supp. 114 (Ct. Cls.). For dictum distinguishing *Baer* but apparently approving its holding, see *Howard* v. *Commissioner*, 202 F. 2d 28 (C.A. 3); *Tressler* v. *Commissioner*, 228 F. 2d 356 (C.A. 9); *Harris* v. *United States*, 275 F. 2d 238 (C.A. 9); *Davis* v. *United States*, 287 F. 2d 168 (Ct. Cls.), reversed on other issues, 370 U.S. 65. For cases merely distinguishing *Baer*, see *Smith's Estate* v. *Commissioner*, 208 F. 2d 349 (C.A. 3); *Richardson* v. *Commissioner*, 234 F. 2d 248 (C.A. 1). The decisions of the Second Circuit and the Tax Court expressly rejecting *Baer* are discussed at pp. 47–49, *infra*.

wife's demands and the urgency of resisting them. The distinction is drawn between demands which would merely diminish the taxpayer's portfolio of income-producing assets, on the one hand, and those which threaten "destruction" of the taxpayer's "income-earning capacity" or his "chief source of income," on the other.[20] What that category seems to mean in practice, in turn, is any case in which the taxpayer's control over an enterprise in which he is employed is jeopardized—*i.e.*, in which a loss of job as well as of assets is threatened. In short, the taxpayers in the privileged category, entitled to a deduction for divorce litigation costs denied to all others, are those who own substantial blocks of stock in corporations of which they are officers.

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[20] *E.g.*, R. 119 (where demand threatens property "without [which] the [husband] might be denied not only the property itself but the means of earning a livelihood"); *McMurtry v. United States*, 132 F. Supp. 114, 116 (where demands threaten property "control over which affects the husband's general income-earning capacity"); *Tressler v. Commissioner*, 228 F. 2d 356 (C.A. 9) (same); *Howard v. Commissioner*, 202 F. 2d 28, 30 (C.A. 9) (distinguishing *Baer* on ground that claims threatened "destruction, to a substantial extent, of his capacity to earn income"); *Smith's Estate v. Commissioner*, 208 F. 2d 349, 354 (C.A. 3) (distinguishing *Baer* as a case where claims "might force her husband to relinquish his controlling interest in a corporation of which he was president" and thus "threatened * * * the loss of his chief source of income"); *Richardson v. Commissioner*, 234 F. 2d 248, 253 (C.A. 4) (distinguishing *Baer* because claims "threaten[ed] * * * destruction of the business from which his income was derived"); *Owens v. Commissioner*, 273 F. 2d 251, 254 (C.A. 5) (threatened control of partnership business which was the taxpayer's "main hope for a livelihood").

2. The *Baer* "exception" is not only in direct conflict with the regulations[2] but it has, we submit, no rational relationship either to the principle to which it is an exception or to the statutory language it purports to apply. Diversified securities are no less "property held for the production of income" than is a controlling stock interest in a single corporation.

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[2] The present version of the regulation (Regs. (1954 Code), § 1.262-1(b)(7)) reads:

> Generally, attorney's fees and other costs paid in connection with a divorce, separation, or decree for support are not deductible by either the husband or the wife. However, the part of an attorney's fee and the part of the other costs paid in connection with a divorce, legal separation, written separation agreement, or a decree for support, which are properly attributable to the production or collection of amounts includible in gross income under section 71 are deductible by the wife under section 212.

That provision derives, with various word changes over the years, from Art. 24-2 of Regs. 86, 94, and 101 (1934, 1936, and 1938 Revenue Acts) and from §§ 19.24-1, 29.24-1, and 39.24(a)-1 of, respectively, Regs. 103, 111, and 118 (all under the 1939 Code). The "Generally" qualification to the first sentence and the following "However" sentence were added in 1952 by T.D. 5889, 1952-1 Cum. Bull. 31, which expressly stated that the amendment was being made to "conform" the regulations to the decision of the Tax Court in *LeMaud* v. *Commissioner*, 13 T.C. 670. The *LeMaud* case had held that, inasmuch as Congress had in 1942 made "periodic payments" of alimony taxable as "income" to the wife (see §§ 22(k) and 23(u)), such items had to be treated as "income" for all purposes and the wife's legal expenses incurred in obtaining such taxable alimony were therefore incurred "for the production or collection of income" and hence deductible. See also the companion decision in *Gold* v. *Commissioner*, 13 T.C. 661. That history establishes that the "Generally" qualification was added specifically to allow for the single stated exception (the "However" sentence) and not otherwise to qualify the disallowance of such expenses.

and resisting a wife's marital demands has exactly the same relationship to the retention of one kind of property as of the other. If, then, litigation expenses to forestall the loss of diversified stocks do not qualify as expenses of "conserving" the stocks within the meaning of § 23(a)(2)—as *Baer* and the cases following it agree [22]—it cannot be that litigation expenses to forestall (against precisely the same kind of threat) the loss of a block of stock in one corporation can qualify as expenses of "conserving" that stock. Whatever the meaning of the word "conservation"—or of § 23(a)(2) as a whole—there is no possible basis for its having a different meaning in one context than the other.[23]

Not only are the distinctions made by *Baer* and its progeny untenable but they are of precisely the sort condemned by this Court in the *Lykes* case for the unjustified discriminations they would produce. Holding that neither the "size" of a claim nor the "urgency" of resisting it could determine its char-

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[22] Compare, in particular, the Court of Claims' own prior decision in *Davis v. United States*, 287 F. 2d 168, reversed in part on other issues, 370 U.S. 65, holding nondeductible the costs of resisting the wife's threat to stock not essential to protect the husband's employment.

[23] What is doubly curious about the *Baer* "exception" is that courts which rely so heavily on the precise wording of § 23(a)(2) ("incurred * * * for * * * conservation * * * of property") should make its application turn upon whether the taxpayer's *job* is threatened as well as his property. A job is a "trade or business," not "property held for the production of income." Any deduction premised upon the relationship of the expenditure to the taxpayer's job would have to be claimed, therefore, not under § 23(a)(2), but under § 23(a)(1). Thus, the courts that purport to find in the language of § 23(a)(2) an exception for the cost of defending claims that threaten the taxpayer's job are in fact relying on the wrong subsection.

acter, the Court noted that if "the relative size of each claim, in proportion to the income-producing resources of a defendant, were to be a touchstone of the deductibility of the expense of resisting the claim," it would produce such bizarre and discriminatory results as making the expense of defending a suit for personal injuries or alienation of affection deductible by one taxpayer who happened to own income-producing property but nondeductible by his "less well-to-do neighbor" owning none (343 U.S. at 125–126). A discrimination, in allowing deduction of the costs of resisting a wife's marital claims, between taxpayers who own substantial blocks of stock in corporations of which they are officers and all other taxpayers is, we submit, equally offensive.

3. In sharp conflict with the *Baer* decision and its followers stand the decisions of the Second Circuit in *Lewis* v. *Commissioner*, 253 F. 2d 821, and *Ditmars* v. *Commissioner*, 302 F. 2d 481.[24] In *Lewis*, the court, having concluded that the *Baer* decision was irreconcilable with *Lykes*, expressly refused to follow it and held nondeductible the taxpayer's expenses of negotiating a marital property settlement which had allegedly "conserved" his ownership of the stock of three wholly-owned corporations.

Although the *Ditmars* case—decided by the Second Circuit since the original argument of this case—does not involve marital litigation, the opinion by Judge Friendly contains an exhaustive analysis of the prin-

[24] The Tax Court, too, has remained firm. See, *e.g.*, *Douglas* v. *Commissioner*, 33 T.C. 349; *Walsh's Estate* v. *Commissioner*, 28 T.C. 1274; cf. *Rockwell* v. *Commissioner*, 37 T.C. 246.

ciples governing deductibility of litigation costs and reaffirms, in a variety of contexts, the basic principle of *Kornhauser*, *Lykes*, and *Lewis*, that the source and nature of a claim, not its threatened consequences, governs the deductibility of the costs of resisting it.[25] Of particular bearing here is the court's express application to §§ 23(a)(1) and (2) of the same tests of deductibility and its repeated emphasis that the question whether a taxpayer's litigation expense relates "to the profit-making * * * [or] to the personal side of his life" (p. 483) turns exclusively upon the source

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[25] In a suit brought by a successor trustee, Mr. Ditmars was charged with having used his effective control over the trust, while his mother-in-law was trustee, for his or her private benefit in a variety of ways—*e.g.*, "churning" the trust's assets to earn fees for himself in his business as broker; causing the trust to purchase stock from a syndicate in which he was interested; putting the trust in the stock of a company to secure his position as president of the company; using trust assets to satisfy personal obligations; and aiding his mother-in-law in her self-dealing with the trust. The litigation was ultimately compromised for a lump-sum payment through the efforts of Mr. Ditmars' attorneys, for whose fees he claimed deductions. In holding part of the fees deductible, the court analyzed each of the activities charged to have been wrongful; classified it as a "trade or business" activity, (dealings with the trust as a broker; employment as president of corporation), an income-producing activity other than a trade or business (interest in stock syndicates), or as neither (aiding mother-in-law's self-dealing; use of trust assets for personal expenses); and held that the activity giving rise to each charge controlled the character of the expense of resisting it—*i.e.*, with the expense of the first class of activities being deductible under § 23(a)(1); of the second class, under § 23(a)(2); and of the third class, non-deductible.

of the asserted liability. The court thus observed that (p. 487):

> To such extent as litigation springs solely from the taxpayer's non-business life, expenses of defending or settling it are "personal" expenses whose deduction is forbidden by [§ 24(a)(1)] even though the litigation might be detrimental to the taxpayer's profit-seeking activities * * *.

And again (p. 488):

> * * * Any argument for deductibility under [§ 23(a)(2)], on the basis that amounts for which Ditmars might be held liable on such claims would deplete income-producing assets is foreclosed by *Lykes* v. *United States*, 343 U.S. 118. Neither can amounts paid in relation to these claims be deducted on the basis that Ditmars was attempting to forestall derogatory publicity so as to preserve his position as president of Gray.

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The purpose of this point has been to establish the basic principle that the nature of litigation costs as "business" expenses (for purposes either of § 23(a)(1) or § 23(a)(2)) or as "personal" expenses (for purposes of § 24(a)(1)) must be determined by the origin and nature of the claim asserted rather than by

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As we have previously pointed out, the knife cuts both ways, and the court properly rejected for the same reasons a converse argument made by the government—namely, that no deduction should be allowed for the defense of activities in connection with the taxpayer's former business as a broker because he was *no longer* in the business and because his *motive* in compromising the case was to protect his reputation, a "personal" asset. Cf. *Kornhauser*, discussed at pp. 36-37, *supra*.

effects an adverse judgment would have. That conclusion, we have shown, is dictated by reason, the authoritative decisions of this Court in *Kornhauser* and *Lykes*, and the intrinsic force of the opinions of the Second Circuit in the *Lewis* and *Ditmars* cases. Not even the conflicting decision of the Eighth Circuit in *Baer*—though a departure in result from a rule that had been taken as settled for 26 years—purports to reject that basic principle, but even if it does, that case and those following it are irreconcilable with the *Lykes* case and cannot stand.

## III

### THE LITIGATION COSTS ATTRIBUTABLE TO THE CHARGES OF PERSONAL MISCONDUCT WERE CLEARLY PERSONAL AND NONDEDUCTIBLE; THOSE ATTRIBUTABLE TO DISPROVING THE CLAIMED EXISTENCE OF COMMUNITY PROPERTY WERE EITHER PERSONAL OR CAPITAL AND NONDEDUCTIBLE IN EITHER EVENT

Accepting the predicate that one must look to the source and nature of the claim to determine the character of the cost of defending it, there remains the question of characterization: which kinds of claims make the defense "personal" and which make it "business"? In many contexts—as in the case of personal injury suits, where the business or personal character of the activity causing the injury will usually be clear—that step is easy, and it poses no difficulty in the context of most divorce litigation. Certainly in common-law states, where the wife is asserting a mere *in personam* right against the husband for maintenance and support (as in the *Baer* case itself), the "personal" or "family" nature of the claim could not

be clearer and that is true whether the claim be viewed as arising from the marriage relationship itself or, more immediately, from the conduct of the husband (*e.g.*, his adultery) on which the wife's "cause of action" for divorce is based.

The community-property aspect of this case, however, introduces a complication and requires further analysis. For this purpose, it is necessary to distinguish between (a) the expenses incurred to defend the charges of respondent's misconduct made by his wife and to support the charges of her misconduct made by him, and (b) those incurred to establish that no community property existed. The former expenses—the bulk of those allowed as deductions by the Court of Claims—are, we will show, plainly nondeductible "personal" expenses. The proper characterization of the latter is more debatable but they must be treated either as "personal" or as "capital" and are in either case nondeductible.

A. THE COSTS OF LITIGATING THE MISCONDUCT CHARGES

The great bulk of the trial proceedings in the State court, which took 24 days and filled over 3,000 pages of transcript, was, as respondent acknowledges, devoted to the proof and disproof of the personal misconduct charged by each spouse against the other, charges that led the appellate court to describe the case as "one of the most sordid and revolting with which" it had ever dealt (282 P. 2d 598, 599). The Court of Claims held the costs of litigating the misconduct charges (both on offense and defense) deductible to the extent that the proof of misconduct would bear upon the division of

any community property. Under California law, if a divorce is granted for adultery or extreme cruelty, the court may divide the community property in such proportions as to it "may seem just."[2] Invoking that power, the wife claimed that, because of the respondent's mistreatment, she should be given some of his "half" of the community property. The respondent, on the other hand, claiming that the wife was at fault, in effect counter-claimed for some or all of her "half" of the community property. It was to defeat that claim of his wife's, and to establish his "counter-claim," that respondent incurred the costs of litigating the misconduct issue that were allowed by the Court of Claims.[3]

Once the source and nature of the claims is examined, it is apparent that the claims underlying the misconduct litigation were purely personal in nature. The claim of each party to an unequal division of the community property was essentially the assertion of a right to a remedy for a personal wrong—the injury done him by the misconduct of the other spouse in the course of their married life. The right the wife asserted thus arose from respondent's alleged

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[2] Cal. Civ. Code, § 146. In cases of divorces based on adultery or extreme cruelty, the court is apparently *required* to grant the innocent spouse more than half of the community property and may award all of it. See *Barham* v. *Barham*, 33 Cal. 2d 416, 202 P. 2d 289; *Wilson* v. *Wilson*, 159 Cal. App. 2d 330, 323, P. 2d 1017.

[3] The proof of misconduct went most directly, of course, to determine to which party the divorce would be awarded and to establish or defeat the wife's right to alimony, but we accept the court's 80-20 allocation as having eliminated those objects from consideration.

cruelty and his adultery, conduct having nothing to do with respondent's income-producing activities. The right he asserted against her arose, in turn, from her alleged cruelty to him. The transactions giving rise to the crossclaims for unequal division of the community property were, in short, of the most "personal" character imaginable, and so, hence, were the costs of prosecuting or defending those claims.[3]

The Court of Claims also premised deductibility of the misconduct litigation costs on the ground that respondent's defense of his wife's charges of scandalous conduct was necessary to minimize the damage to his reputation, which might have caused General Motors to cancel his corporations' franchises. That aspect, however, is answered in full by the basic principle that the origin, not the consequence, of the claim controls. If resisting a claim to avoid losing income-producing property is not deductible, *a fortiori* resisting a claim to avoid damage to reputation which might then cause a loss of income-producing property is not. See *Lewis* v. *Commissioner*, 253 F. 2d 821 (C.A. 2); *Ditmars* v. *Commissioner*, 302 F. 2d 481 (C.A. 2).

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[3] The nature of the "unequal division" aspect of the litigation might be made clearer by likening it to tort litigation. If a wife sued her husband for damages for assault and battery, and the husband counterclaimed for her assault and battery upon him, the costs of the litigation, under our analysis, would plainly be personal. Assume that, instead of a tort action, the suit, though similarly based on charges and countercharges of assault and battery, is one for divorce and an unequal division of the community property (the existence of which is conceded). Are the expenses any less personal because the remedy for the personal wrong is to be in the form of giving the wronged party part of the other spouse's "half" of the community property rather than money damages?

B. THE COSTS OF LITIGATING THE EXISTENCE OF COMMUNITY PROPERTY

The final item to be considered is the amounts spent by respondent in controverting the *existence* of community property, an issue entirely distinct from the parties' respective claims to an unequal *division* of whatever community property there was.

Under California law, earnings from personal services are community property, while gains or profits derived from separate property (*e.g.*, property owned prior to marriage) are separate property. Consequently, if, for example, a husband owns as separate property the assets of an unincorporated business to which he also devotes his services, it is necessary to allocate the earnings of the business between those attributable to his services (community property) and those attributable to his capital (separate property). This case involved an attempt to make an equivalent allocation of the retained earnings of the respondent's *incorporated* businesses.

Between the date of the marriage (1946) and the date of the divorce (1952), the net worth of respondent's corporations increased from approximately $200,000 to $800,000, the increase resulting from the retention of earnings in the corporations. Respondent's wife argued that the $600,000 of retained earnings were attributable to the respondent's services and thus impressed with a community inter-

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In the case of the two corporations in which the respondent owned less than all the stock, the computations included, of course, only the percentage of the net worth allocable to his share of the stock.

est. Since the right to the retained earnings was represented by the stock, that claim, if successful, would mean that the stock was *pro tanto* community property—in effect, treating the husband as having made a contribution to capital with community property. Respondent's defense, which he proved, was that he was paid (and devoted to community purposes) salaries that were more than generous for his services and that the large earnings of the corporations were attributable rather to their capital assets (in particular, their ownership of the Chevrolet and Pontiac franchises in the period of unprecedented demand for automobiles immediately following World War II). Mrs. Gilmore challenged, it would appear, not so much the facts as the theory of the defense, contending that as a matter of law the allocation must be made by attributing to the capital only a "fair return" on the investment and deeming all the rest of the earnings—regardless of their actual relationship to any possible value of his services—to be attributable to the respondent's personal services. The California Supreme Court, as had the trial court, upheld the respondent's theory and, approving the findings that respondent's salaries were more than ample compensation for his contributions, held that there was no community property interest in the retained earnings or, therefore, in the stock. 45 Cal. 2d 142, 149, 287 P. 2d 769, 773–774. The question here is how the costs of that part of the State litigation should be treated for tax purposes.

We do not believe the Court need now resolve that question. Unlike the expenses of litigating the mis-

conduct issues, the nondeductibility of those costs does not follow automatically from a rejection of the *Baer* doctrine and a holding that the characterization of litigation costs turns upon the nature and source of the claims asserted. For even accepting that principle, and thus looking to the nature of the wife's claim (a claim that some part of the stock was community property), there remains a thorny problem of analyzing the character of that claim and of pigeonholing as "personal," "business," or "capital" the expenses of resisting it. A decision of that issue of characterization was the object neither of the governments' petition for certiorari (to have the *Baer* case disapproved) nor of this Court's granting it (presumably to resolve the conflict with the Second Circuit over the validity of the *Baer* doctrine). Nor has that question been separately considered by the Court of Claims, which based its decision as to all the expenses on the common broad ground, the theory of the *Baer* case, that it is enough that a loss of the suit, regardless of its nature, would have resulted in a loss of income-producing property. Moreover, since the great bulk of the State litigation was over the misconduct issues,[1] the present question goes only to a

[1] See R. 132. Of the trial transcript, 2,498 pages were concerned with the misconduct allegations, 508 with the existence of community property. Of the trial court's opinion, 27 pages were devoted to the divorce and misconduct issues, only 3 lines to the community-property issue. Of the respondent's brief used in both the appellate courts, 101 pages were devoted to the misconduct and divorce issues, only 14 pages to the community-property issue. The decision of the District Court of Appeals, reversing the judgment and directing a new trial, was based entirely on the misconduct and divorce issues. 282 P. 2d

small part of the expenses for which a deduction was allowed. Under the circumstances, we suggest that should the Court agree with us on the main issues discussed in preceding portions of this brief, and thus on the necessity for reversing the judgment below at least insofar as it allowed deduction of the expenses of litigating the misconduct issues, the proper course would be to reverse the judgment and remand the case to the Court of Claims for it to consider, in the light of this Court's decision on the main issues, the proper characterization of the costs of resisting the wife's claim that part of the stock was community property. Not only is there no reason why this Court should be called upon to decide that question in the first instance, but the suggested course will also, we may note, considerably lessen the Court's burden, for we are frank to acknowledge that that question, though of relatively less importance, is of considerably greater difficulty than those considered in the previous portions of this brief.

We will, nevertheless briefly state our views of how that item should be treated, if only to indicate

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[58] Respondent's petition for rehearing, as well as his petition for a hearing in the California Supreme Court, were consequently similarly limited exclusively to those issues. Finally, less than one-quarter of the opinion of the California Supreme Court, which reinstated the trial court's judgment in favor of respondent, was devoted to the community property issue. We do not, of course, suggest that those statistics are by themselves an adequate basis for allocating the total costs, but they are indicative that only a relatively small part of the state litigation—or of the part of the costs for which a deduction was allowed—was concerned with the existence of community property.

the nature of the issue and the additional and quite different problems it raises. We will first show that the litigation cost must in any event be treated as a "capital" expenditure rather than a "current" expense of income production or of the holding of property. The question whether the litigation cost should be treated as a "personal" cost of the marriage then becomes important only in deciding whether the respondent should be allowed to add the amounts expended to the basis of his stock.

1. That §§ 23(a)(1) and 23(a)(2) alike[*] limit deductions to "current" expenses and deny deductions for "capital" expenditures is not to be doubted. The source of the limitation is usually found in the words "ordinary" or "expenses," but it is equally manifest in the references to the expenses of "carrying on," "producing," "collecting," "managing," "maintaining," or (if understood in the sense of protecting against fire, theft, etc.) "conserving." All of those terms imply, we suggest, the recurrent, regular costs of making the assets productive or of holding or carrying them over time—*i.e.*, the expenses which produce the year's income and leave the assets at year's end none the worse for it—as distinguished from the once-for-all-time expenditures that create the assets or secure for the indefinite future the ownership or use of them. Whatever the source, however, the distinction

[*] The history of § 23(a)(2) showing that there is no difference between it and § 23(a)(1) for purposes of the business-personal distinction (see pp. 24–27, *supra*) equally goes to show that there is no difference between them for purposes of the capital-ordinary distinction. See *Bowers* v. *Lumpkin*, 140 F. 2d 927 (C.A. 4), certiorari denied, 322 U.S. 755.

exists and the only problem is to apply it, an undertaking in which one looks in vain for any more precise standards than the accounting concepts of items chargeable to "capital" account and those chargeable to "current" account (cf. §113(b)(1)(A)), the statutory object to "clearly reflect income" (see §§41, 43), and the applications of those principles to particular expenditures to be found in the decisions and regulations.

The classic example of a "capital" expenditure is, of course, the cost of acquiring ownership of a capital asset, but hardly far removed from that is the cost of preserving one's ownership against a conflicting ownership claim. Thus it is that the regulations provide that (Regs. 118, §39.23(a)-15(k)):

> Expenditures incurred in defending or perfecting title to property * * * constitute a part of the cost of the property and are not deductible expenses. * * *

The rationale of that rule is evident, for the costs of retaining a capital asset against one asserting rights not themselves arising from a business transaction[4]

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[3] There is, of course, the specific provision disallowing deductions under any provision of the Code for amounts "paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate" (§24(a)(2)), but that covers only a very limited class of capital expenditures and has never been read as qualifying the broader restriction implicit in the limitation of §23(a) to ordinary "expenses."

[4] We are concerned here only with an assertion of conflicting "property" rights not themselves arising from a business transaction. If the claim asserted arises from an ordinary-income business transaction, the fact that the rights asserted are in the form of a claim to property ought not bar deductibility.

have no more relationship to the current production of income or the current holding of property than do the costs of initial acquisition. Each is an outlay incurred for the right to hold the asset (and enjoy whatever income it may produce) for its useful life and is properly treated as a capital cost of securing that right, to be spread over the useful life of the asset if it is depreciable or, if not, offset against the proceeds of its later disposition.

The cost of litigating, in a divorce proceeding, whether particular assets are the husband's separate property to be retained by him or are community property to be divided with his wife would seem plainly to be a cost of defending the husband's title to the property within the meaning and rationale of

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See *Kornhauser v. United States*, 276 U.S. 145 (discussed at pp. 36-37, *supra*), where the costs of defending a suit by a former business partner for an accounting for fees received were none the less deductible because the contested fees had been received in the form of stock and the suit was thus one to establish the plaintiff's rights to a share of the stock. It should be noted, however, that the relative importance of the source as compared to the consequence of an asserted claim is not necessarily the same for purposes of making the capital-current distinction as it is for purposes of making the business-personal distinction, and it was only to the latter distinction that our earlier discussion of the *Kornhauser* case was directed.

Respondent has asserted that the difference between separate property and community property is not technically a matter of "title," apparently because of the husband's virtually unlimited powers, as manager of the community estate, to dispose even of community property. We eschew fine debates, for the regulation is concerned, not with such technical niceties of local law but with the tax treatment of the costs of retaining one's beneficial ownership of capital assets against one asserting an adverse property right, and a community property dispute is fully within any rationale to be drawn from it.

the regulations; it is a one-time cost of securing, in perpetuity, the husband's undivided ownership of a capital asset and is therefore a capital expenditure. And so the cases have held. See *Harris* v. *United States*, 275 F. 2d 238 (C.A. 9); *Shipp* v. *Commissioner*, 217 F. 2d 401 (C.A. 9), and cases there cited. *But cf.*: *Owens* v. *Commissioner*, 273 F. 2d 251 (C.A. 5). The only apparent basis for doubt is the fact that the right asserted by the wife in this case was in its nature, in State law concepts, a right to share in earnings attributable to personal services, a fact that gives to her claim something of an ordinary-income flavor. The earnings she sought to reach, however, were those retained by the corporations and she could reach them only by impressing a community-property interest upon the stock itself.[20] And notwithstanding California's willingness to pierce the corporate veil to determine the rights of the spouses *inter se*, a stockholder's interest in the assets of a corporation, retained earnings as well as contributed capital, is treated for federal tax purposes as a *capital* interest. Mrs. Gilmore's claim that a part of the stock was community property was thus an assertion of a property right in a capital asset notwithstanding that the state law theory was that the part of the stock so claimed represented earnings which, though nominally belonging to the corporations (and so treated for tax purposes), were "attributable" to the respondent's services.[20]

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[20] The capital nature of the claim would be self-evident, we suggest, if the wife's claim had been successful and the question were the proper tax treatment of her receipts. Suppose that the wife had established that $500,000 of the retained surplus of [illegible]

2. We have thus far shown that even treating the wife's claim as one of independent "property" rights, and ignoring their source in the marriage relationship, the costs of resisting them were nevertheless not currently deductible because of their "capital" nature. There remains a question—not directly involved in this case[7] but relevant to a consideration of the proper characterization of the item—whether the expenditures should be added to the basis of respondent's stock or whether the source of the wife's claim in the marriage relationship requires that they be treated as "personal" or "family" expenses and be

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the wholly-owned corporation was attributable to her husband's personal services; that that amount of retained earnings represented one-third of the net worth of the corporation; that the contribution of those services to the corporation constituted, in effect, a contribution to capital made out of community property, converting the stock of the corporation, *pro tanto*, into community property; and that one-third of the stock was accordingly community property. Had the wife been awarded, on that theory, one-sixth of the stock as her share of the community property, it is evident, we think, that her receipt would not have been treated for federal tax purposes as a receipt of earnings from personal services (and hence taxable as ordinary income). She would be treated, rather, as having merely made a nontaxable "division" with her husband of a capital asset in which they had each had an existing property interest. Cf. *United States* v. *Davis*, 370 U.S. 65, 68–71. The fact that, in creating the property interest, the state did so on a theory of protecting the wife's rights to share in the "earnings" from her husband's personal services would be irrelevant. And just as the wife would there be treated as claiming, not an income item, but an interest in a capital asset, so here the husband must be treated as seeking to retain, not income, but a capital asset.

[7] The question would arise only if and when the respondent made a taxable disposition of his stock and it became necessary to determine his capital gain or loss on the sale or other disposition.

given no tax recognition whatever. The question, in short, is whether the respondent's litigation costs are properly to be treated as a cost of his stock or as a cost of his marriage. While we acknowledge that the question is not free from doubt, it is our view that the latter is the preferable treatment.

In a common-law jurisdiction, a wife's right upon divorce to an allowance for support or maintenance or to a "share" of her husband's property is treated, not as a "property" interest, but as merely an independent personal liability of the husband to his wife. *See United States v. Davis*, 370 U.S. 65. The costs of resisting such a claimed personal liability (like the costs in this case of resisting the wife's claim to an unequal division of the community property because of misconduct) would plainly be "personal" or "family" expenses and, as such, would not only be nondeductible but could also not be added to the husband's basis. The problem here is whether the fact that a wife's rights to share in community property are deemed to be vested "property" rights makes a difference and justifies adding the cost of resisting a claim of such rights to the basis of the property.

Were the Court writing on a clean slate, we would contend that the purported "property" interest of a wife in community property is, during the marriage, so lacking in substance that it should be given no effect for tax purposes and the assertion of such rights upon divorce or death should, accordingly, be treated as an assertion not of pre-existing "property" rights but of inchoate "marital" [illegible] not significantly different in kind from those recognized in com-

mon-law jurisdictions. For present purposes, however, we will assume that such an argument is foreclosed (see, *e.g.*, *Poe* v. *Seaborn*, 282 U.S. 101; *United States* v. *Davis*, 370 U.S. 65, 69–71) and that a claim based upon the wife's "property" interest in community property is to be treated in all respects like a claim based upon any other kind of "vested" property interest. Even so, we submit, that does not govern this case, for here the dispute was not over rights flowing from an acknowledged property interest but rather over the *creation* of the property interest itself—*i.e.*, over whether the wife's inchoate "marital" right to a share of her husband's earnings from personal services ever matured into a "property" interest.

The distinction can be suggested by a case in which both questions are present. Suppose the earnings from an unincorporated business of the husband's were deposited during the marriage into a special bank account and that the wife claims (1) that, say, 70% of the business earnings were attributable to the husband's personal services and that 70% of the funds in the account were accordingly community property and (2) that some of the funds from that account were used to buy real estate owned by the husband at the time of the divorce, 70% of which is accordingly community property. The first issue, we contend, involves an assertion of an inchoate right, arising directly from the marriage relationship, to a share of the proceeds of the husband's personal services. The expenses of establishing and fixing that right—*i.e.*, of establishing the *creation* of a community-property in-

terest—are thus, we say, costs of the marriage and hence "personal." Once the community-property interest has been created (or its existence established in the litigation), however, the following of it into the real estate involves an assertion of "property" rights that can be treated as independent of their marital source.* In short, an assertion that the marital relationship gave rise to community property is an assertion of "marital" rights the defense of which is personal; an assertion that established or acknowledged community-property interests (*e.g.*, in a bank account) have given rise to another consequence (*e.g.*, to make other property traceable to the account community property) is an assertion of "property" rights, the defense of which, although capital in nature (see above), is not made "personal" by its relationship to the marriage.

The difference is perhaps less one of kind than of degree—a difference in how "proximate" the causal relationship is between the marriage and the claim and hence the defense costs. A claim that a property interest was created because of the marital status of

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* The cases holding the costs of community property litigation to be non-personal and denying their deduction only because they are capital (and thus implying a right to capitalize the costs as an addition to basis) involved disputes only of the latter category (tracing acknowledged community funds into purchased assets, or negotiating over the physical division of acknowledged community property) and are thus not inconsistent with our position here. See *Harris* v. *United States*, 275 F. 2d 238 (C.A. 9); *Shipp* v. *Commissioner*, 217 F. 2d 401 (C.A. 9). See, also, Jones, J., dissenting in *Owens* v. *Commissioner*, 273 F. 2d 251 (C.A. 5), the majority opinion of which allowed a current deduction on the authority of *Baer*.

the wife is deemed to arise "proximately" from the marriage; once the "property" interest is acknowledged or established to have been created, the causal relationship is considered to be broken and claims premised upon the acknowledged property right are not traced back to the martial origin of the property interest.

If that distinction be accepted, it would follow that the expenses here—since the dispute was whether a community-property interest ever came into being and thus involved an assertion of rights premised directly on the marriage—must be characterized as a "personal" cost of the marriage for which no tax recovery is allowable rather than as a capitalizable cost of the stock to be added to its basis. As we have noted, however, that question need not be decided in this case, for even if the cost is in some way assignable to the stock rather than to marriage it remains, as shown in paragraph 1, an expenditure capital rather than current in nature and hence nondeductible for that reason. We reemphasize, finally, that the Court need not dispose of that item of cost at all (*i.e.*, the expenses of litigating the *existence*, as distinguished from the *division*, of community property) but may properly leave the characterization of that item—involving questions quite different from those the case was brought here to resolve—to the Court of Claims on remand.

## CONCLUSION

For the reasons stated, the judgment of the Court of Claims should be reversed.

Respectfully submitted.

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## APPENDIX

Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In general.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.

* * * * * * *

(2) *Non-trade or non-business expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

* * * * * * *

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses * * * [with certain exceptions].

* * * * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

* * * * * * *

(b) *Adjusted Basis.*—* * * *.

* * * * * * *

(1) *General rule.*—Proper adjustment in respect of the property shall in all cases be made—

(A) For expenditures, receipts, losses, or other items, properly chargeable to capital account, * * *.

* * * * * * *

Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.):

SEC. 162. TRADE OR BUSINESS EXPENSES.

(a) *In General.*—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.

* * * * * *

SEC. 212. EXPENSES FOR PRODUCTION OF INCOME.

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property held for the production of income; or

(3) in connection with the determination, collection, or refund of any tax.

SEC. 262. PERSONAL, LIVING, AND FAMILY EXPENSES.

Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.

SEC. 1016. ADJUSTMENTS TO BASIS.

(a) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—

(1) for expenditures, receipts, losses, or other items, properly chargeable to capital account, * * *.

* * * * * * *

California Civil Code, West's Annotated California Codes, Cum. Pocket Supp.:

SEC. 146. *Community Property and Homestead; Disposition on Divorce or Separate Maintenance*

*Order.* In case of the dissolution of the marriage by decree of a court of competent jurisdiction or in the case of judgment or decree for separate maintenance of the husband or the wife without dissolution of the marriage, the court shall make an order for disposition of the community property and the quasi-community property and for the assignment of the homestead as follows:

(a) *Community property, cases of adultery, cruelty or insanity.* If the decree is rendered on the ground of adultery, incurable insanity or extreme cruelty, the community property and quasi-community property shall be assigned to the respective parties in such proportions as the court, from all the facts of the case, and the condition of the parties may deem just.

(b) *Community property, other cases.* If the decree be rendered on any other ground than that of adultery, incurable insanity or extreme cruelty, the community property and quasi-community property shall be equally divided between the parties.

* * * * * * *

Treasury Regulations 118 (1939 Code):

SEC. 39.23 (a)-15 *Nontrade or Nonbusiness Expenses.*

* * * * * * *

(d) Except for the requirement of being incurred in connection with a trade or business, a

deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23(a)(1)(A) of an expense paid or incurred in carrying on any trade or business. This includes restrictions and limitations contained in section 24. * * *

(e) Capital expenditures, and expenses of carrying on transactions which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income * * * are not allowable as non-trade or nonbusiness expenses. * * *

* * * * * *

(k) Expenditures incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of income which, if and when recovered, must be included in income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses. Attorneys' fees paid in a suit to quiet title to lands are not deductible; but if the suit is also to collect accrued rents thereon, that portion of such fees ~~is deductible~~ which is properly allocable to the services rendered in collecting such rents. Expenditures incurred in protecting or asserting one's rights to property of a decedent as heir or legatee, or as beneficiary under a testamentary trust, are not deductible. Expenses paid or incurred by an individual in the determination of liability for taxes upon his income are deductible. If property is held by an individual for the production of income, amounts expended in determining a property tax imposed with respect to such property during the period when so held are deductible. Expenses paid or incurred by an individual in determining or contesting any liability asserted against him do not become de-

ductible, however, by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability. Thus, expenses paid or incurred by an individual in the determination of gift tax liability, except to the extent that such expenses are allocable to interest on a refund of gift taxes, are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such tax liability or even though, in the event of a claim for refund, the amount received will be held by him for the production of income.

* * * * *

SEC. 39.24(a)-1 *Personal and Family Expenses.*—* * * Generally, attorneys' fees paid in a suit for divorce or separate maintenance are not deductible. However, the part of an attorney's fee paid in a divorce or separate maintenance proceeding which is properly attributable to the production or collection of amounts includible in gross income under section 22(k) is deductible under section 23(a)(2). * * *

SEC. 39.24(a)-2. *Capital Expenditures.*—(a) *Expenditures except non-depreciable mine development expenditures.*—* * * The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. * * *

Treasury Regulations on Income Tax (1954 Code):

SEC. 1.212-1 *Nontrade or Nonbusiness Expenses.* * * *

* * * * *

(c) Expenses of carrying on transactions which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income * * *

are not allowable as nontrade or nonbusiness expenses. * * *

* * * * *

(BB) An expense (not otherwise deductible) paid or incurred by an individual in determining or contesting a liability asserted against him does not become deductible by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability.

(n) Capital expenditures are not allowable as nontrade or nonbusiness expenses. * * *

* * * * *

SEC. 1.262–1 *Personal, Living, and Family Expenses.*—(a) *In General.*—In computing taxable income, no deduction shall be allowed, except as otherwise expressly provided in chapter 1 of the Internal Revenue Code of 1954, for personal, living, and family expenses.

(b) *Examples of Personal, Living, and Family Expenses.*—Personal, living, and family expenses are illustrated in the following examples:

* * * * *

(7) Generally, attorney's fees and other costs paid in connection with a divorce, separation, or decree for support are not deductible by either the husband or the wife. However, the part of an attorney's fee and the part of the other costs paid in connection with a divorce, legal separation, written separation agreement, or a decree for support, which are properly attributable to the production or collection of amounts includible in gross income under section 71 are deductible by the wife under section 212.

* * * * *

SEC. 1.263 (a)–2 *Examples of Capital Expenditures.*

* * * * *

(e) The cost of defending or perfecting title to property.

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# In the Supreme Court
OF THE
# United States

OCTOBER TERM, 1962

**No. 21**

UNITED STATES,
*Petitioner,*
vs.
DON GILMORE and SUE GILMORE,
*Respondents.*

**On Writ of Certiorari to the United States Court of Claims.**

## SUPPLEMENTAL BRIEF FOR RESPONDENT DON GILMORE

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UNITED STATES,

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## SUPPLEMENTAL BRIEF FOR RESPONDENT DON GILMORE

### INTRODUCTORY STATEMENT

The brief of petitioner, although essentially similar to the brief which it replaces, adds some additional thoughts and materials which call for a response by respondent. This brief will not replace but will be supplemental to respondent's brief heretofore filed.[1]

[1] Respondent's brief filed in the 1961 term (No. 257) will be referred to herein as Resp. Br.

## STATEMENT

Petitioner has made the following important concessions of fact.

1. "We do not challenge the Court of Claims allocation of the expenses. * * *" Pet. Br. p. 8.

2. "We concede that the sole reason why the respondent incurred the expenses for which a deduction was allowed was to prevent the loss of his stock and possibly his job." Pet. Br. pp. 8, 9.

3. "We * * * stipulate that the sole reason why respondent spent the $32,500 was to keep his stock, his corporations' franchises, and his jobs." Pet. Br. p. 16.

4. "* * * We acknowledge that there was a direct and immediate relationship between the expenses and the retention of income-producing property (the stock) and of an income-producing capacity (the job), for that was indeed the sole reason why the expenses were incurred." Pet. Br. p. 16.

---

## ARGUMENT

I. The first concession of petitioner that "we do not challenge the Court of Claims allocation of the expenses" relates to the finding of fact number 30. (R. 137). This finding states that the evidence establishes that 80 per cent *or more* of the expenses were for services to defeat the wife's claims to one-half of the value of the increase of his stock and to estab-

lish that no portion of the stock was community property. To defeat the claims, to one-half of the value of the increase and to establish that no portion of the stock was community property, in legal effect means the same thing because the wife automatically becomes entitled to one-half of any community property. It should be observed that all that the wife claimed was one-half, not more than one-half.

Petitioner, however, in the face of said concession and said allocation in finding 30 asserts that the allocation be split into segments, viz.: (1) establishing that no part of the stock was community property, (2) establishing his right, and defeating his wife's, to more than half of whatever community property there was; and (3) protecting his reputation with General Motors against charges of personal misconduct. Pet. Br. pp. 7, 8. Again at page 51 of petitioner's brief it is asserted that "it is necessary to distinguish between (a) the expenses incurred to defend the charges of respondent's misconduct made by his wife and to support the charges of her misconduct made by him and (b) those incurred to establish that no community property existed." Again under the heading on page 54 of petitioner's brief, "The Costs of Litigating the Existence of Community Property," petitioner suggests that this court should remand the case to the court below to consider the amount to be allocated to the costs of resisting the wife's claim that part of the stock was community property and also for the proper characterization of such costs. Pet. Br. pp. 55, 57, 66.

But the Court of Claims has already considered and decided upon the various services rendered by respondent's attorneys and the proper allocation of their charges. The court below found from the evidence that the major part (80% or more) of the compensation paid to the attorneys was for their accomplishment in defeating the wife's claim to one-half of the increase in the value of the stock. (R. 137.) Petitioner has not directly attacked this finding of fact. Moreover, this finding is conclusive on the Supreme Court. *U.S. v. Esmond-Pettis*, 308 U.S. 26, 29, 58 S. Ct. 112, 114; *Niles Bement Pond Co. v. U.S.*, 281 U.S. 357, 360, 50 S. Ct. 251, 252.

Petitioner suggests that the services of the attorneys with respect to misconduct would not have had to be so intense and so extensive if it were not for the possibility that the wife might get the divorce and more than half of whatever amount of community property might be determined. However this was for the Court of Claims as a trier of fact to consider, and a review of the findings shows that it did. What weight was given to it does not necessarily have to appear in the findings.

Thus the concession aforesaid made by petitioner and the findings of fact of the Court of Claims preclude the position taken by petitioner that the 80% of the expenses be split up and further allocated.

II. The other concessions (numbers 2, 3 and 4) of petitioner concede that the expenses in question were incurred solely to protect, save from loss and in that

sense to conserve or preserve respondent's stock. But, says petitioner, the expenses are non-deductible because the origin and nature of the expenses characterizes them primarily as "personal" expenses and perhaps in part capital expenditures. Pet. Br. 16.

The origin and nature of the expenses (as distinguished from cause and purpose), contends the petitioner, have been tainted by the divorce action and thus casts them as personal expenses under Internal Revenue Code Sec. 24(a)(1) and Regulations 118, Sec. 39.24(a)-1 and 1954 Code Sec. 262 and Regulations 1 (1954 Code) Sec. 1.262-1(b)(7). It has been previously shown (Resp. Br. pp. 15, 16) that the Regulations 118 Sec. 39.24(a)-1 and Regs. 1 (1954 Code) Sec. 1.262-1(b)(7) recognize that attorney's fees are deductible even though incurred and have their origin in a divorce case if properly attributable to the production or collection of alimony income. The regulations do not provide that the deductibility of attorney's fees in connection with the production or collection of alimony is the only case in which the deduction of attorney's fees is to be allowed in regard to matters arising in a divorce case. This so-called exception comes under Sec. 23(a)(2) and Sec. 212(1) and (2) which treat expenses paid or incurred for the management, conservation or maintenance of property held for the production of income as co-extensive with expenses paid or incurred for the production or collection of income. Therefore if attorney's fees are for services to

conserve property held for the production of income, the result should be the same.

As is pointed out by petitioner's brief (footnote p. 45), the regulations were amended to recognize the deductibility of attorney's fees incurred in the production or collection of alimony income, to conform to the decisions in *Le Mond v. Commissioner*, 13 T.C. 670, and *Gale v. Commissioner*, 13 T.C. 661. In the latter case the Commissioner argued that "such expenses arose out of the marital relationship existing between the petitioner and her husband and, therefore, constituted purely personal and family expenses, the deduction of which is expressly prohibited by section 24(a)(1) of the code." 13 T.C. p. 667. The Tax Court rejected this argument. The test laid down by the Tax Court is as follows:

> "To be deductible under section 23(a)(2), expenses must be ordinary and necessary, reasonable in amount, and *must bear a reasonable and proximate relation* to the production or collection of income, or for the management, conservation or maintenance of property held for the production of income." (Emphasis added) 13 T.C. p. 667.[2]

---

[2] To underline the conflict between *Bass v. Commissioner*, 196 F. 2d 643 (C.A. 8), and the cases following it (Resp. Br. pp. 16-17), and *Lewis v. Commissioner*, 253 F. 2d 821, petitioner states in a footnote: "The Tax Court, too, has remained firm." (Pet. Br. 47). As support petitioner cites the leading authority of the Tax Court *Douglas v. Commissioner*, 33 T.C. 349. It is submitted, however, that *Douglas v. Commissioner* does not repudiate *Bass v. Commissioner*, *supra*, any more than did the Court of Claims in the recent case of *Davis v. U. S.*, 287 F. 2d 165, which was reversed on other issues, 370 U.S. 65, and on the facts of which the court held not deductible the costs of resisting the wife's demands in a

Petitioner's footnote (Pet. Br. 40, 41) discussing *Joyce v. Commissioner*, 3 B.T.A. 393, is reminiscent of the argument in the brief of the Commissioner in *Gale v. Commissioner*, *supra*, relying on *Joyce v. Commissioner* and other early cases. With reference to the Commissioner's argument that the lawyer's fees were personal and family expenses within the meaning of section 24(a)(1), the court in *Gale v. Commissioner* said, "The cases relied on by the Commissioner on brief . . . are distinguishable either on the facts presented or by the circumstance that neither section 23(a)(2) nor section 22(k) was part of the revenue laws when the cases were decided." 43 T.C. 661, 663.

In a footnote (Pet. Br. 39), petitioner refers to 1954 Code Sec. 212(3) which permits the deduction

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divorce action to stock which was not necessary to the husband for a livelihood as an officer and director of the corporation.

The Tax Court saw a distinction in the facts of *Douglas* from the facts in *Bates v. Commissioner*, *supra*, *Bates v. Commissioner*, 241 F. 2d 904 (C.A. 6), and *H. Wachtel v. U.S.*, 167 Ct. Cl. 132, F. S. 114, but did not disapprove or state that it refused to follow the rule of those cases. The court in *Douglas* stated in reference to those cases:

> "It is readily seen that these cases allowing deduction of expense under section 23(a)(2), as being conservatory of income producing property all concerned property having peculiar and special value to the husband aside from its normal or intrinsic value. The opinions overlap resulting in the effect that the controversy between husband and wife did not go to the question of liability for alimony or even its amount, but solely or primarily to the manner in which it might be paid.
>
> "There is not one in the instant case to bring it within the rationale of the above cases. The community property had not peculiar or special value to petitioner aside from its normal or market value." 23 T.C., p. 356.

of expenses incurred "in connection with the determination, collection or refund of any tax." Although this provision is just as much subject to the personal restrictions of Sec. 262 as subdivisions (1) and (2) of Sec. 212, petitioner admits that legal expenses incurred in connection with the determination of any tax even personal in origin (i.e. personal property tax, personal income tax, gift tax, etc.) are deductible.

III. Petitioner mistakenly compares the claim of the wife to one-half of the increase in value of respondent's stock with the claim of the government to a gift tax in *Lykes* v. *United States*, 343 U.S. 118, on the ground that the origin of attorney's fees incurred in both cases was for services in defense of personal liabilities. (Pet. Br. 36, 38, 39, 40.)

Since this case was first argued this court decided *United States* v. *Davis* (6/4/62), 370 U.S. 65, 82 S. Ct. 1190. The court's decision leaves no doubt that when community property rights are involved they cannot be ignored as petitioner would do in Points I and II of its brief. (Pet. Br. 17) *United States* v. *Davis* makes it clear that unlike claims of wives in common law states, a wife's demand in respect to community property is not a claim of personal liability of the husband. (Petitioner seems to admit this is so. Pet. Br. 63.) When a wife makes a claim to community property against her husband in a proceeding for the dissolution of community property which may, but not necessarily, occur in the divorce case, the claim is one of a right to a division of alleged community property. A quotation from the

opinion in *United States* v. *Davis* 82 S. Ct. p. 1193, will make this clear.

> "Regardless of the tags, Delaware seems only to place a burden on the husband's property rather than to make the wife a part owner thereof. In the present context the rights of succession and reasonable share do not differ significantly from the husband's obligations of support and alimony. They all partake more of a personal liability to the husband than a property interest of the wife. The effectuation of these marital rights may ultimately result in the ownership of some of the husband's property as it did here, but certainly this happenstance does not equate the transaction with a *division* of property by co-owners. (Emphasis added.) Although admittedly such a view may permit different tax treatment among the several States, this Court in the past has not ignored the differing effects on the federal taxing scheme of substantive differences between community property and common-law systems. *E.g.*, *Poe* v. *Seaborn*, 282 U.S. 101 (1930). To be sure Congress has seen fit to alleviate this disparity in many areas, e.g., Revenue Act of 1948, 62 Stat. 119, but in other areas the facts of life are still with us."

IV. The parallel between the situation in *Kornhauser* v. *United States*, 276 U.S. 145, and the situation involving attorney fees in an action between husband and wife for an accounting and dissolution of community property, is most striking.

In *Kornhauser* there had been a suit for an accounting between two former law partners, in which it was

claimed by one against the other that stock in a corporation which was acquired after the dissolution of the partnership by one of the partners was received for services performed during the existence of the partnership and should be divided between the partners. The defense of the suit was successful and the attorney's fee paid by the successful partner was taken as a deduction from his gross income as a business expense. The deduction was disallowed on the ground that it was a personal expense, the extra tax was paid and a suit for refund of the tax paid was subsequently filed in the Court of Claims. A demurrer to the petition for refund of the tax was sustained on the ground that the attorney's fee was not a deductible business expense but was a personal expense. Apparently the government also contended that the expense was incurred to protect property and was non-deductible as a capital expense. (See *Rassenfoss v. Commissioner*, 158 F. 2d 764, 766). The Court of Claims was reversed on the holding that the expense was a business expense having proximately resulted from the business of the taxpayer.

In the case at bar, Don Gilmore, the respondent, and his wife were, under California law, marital partners, both being equally entitled to community earnings and profits. (Resp. Br. 12, 13, 14, 15) In the action by the wife against respondent, the wife alleged that she was entitled to one-half of the increase in value of his stock, the gain being attributable to the earnings of the community. Respondent contended that the gain was attributable to his separate property and that it should not be divided with his wife.

There was an accounting of the community earnings and expenditures in the action and the court on the facts and the law held that the increase in value of the stock was not community property and did not have to be divided with the wife. The respondent incurred attorney's fees in the proceeding which he deducted from his gross income on the ground that they were incurred under section 23(a)(2) to conserve property held for the production of income. The Commissioner of Internal Revenue disallowed the deduction of the expenses on the ground that they were personal under section 24(a)(1). The Court of Claims reversed on the ground that the attorney's fees were proximately related to the conservation of property held for the production of income.

If we assume for a moment that the two law partners in *Kornhauser* were husband and wife, should the result have been any different if the accounting action in regard to the stock had occurred in divorce proceedings between them? Would the fact that the dissolution of the partnership occurred because of marital differences between the husband and wife defeat the right to the deduction of the attorney's fees as personal expenses in the accounting action? It is submitted that the result in *Kornhauser* would not have been different since the rule laid down in that case required only that the expense proximately relate to the business of the partnership.

In the case at bar, respondent and his wife were not in business but they were quasi-business partners and the increase in value of stock of the respondent

was subject to an accounting and the possibility that it was in whole or in part community property consisting of community earnings. The stock was property held for the production of income within section 23(a)(2). The claim of a wife to half of the increase in the value of the stock failed.

The analogy of *Kornhauser* to *Gilmore* is clear. It was the purpose of Sec. 23(a)(2) to afford equality of treatment with Sec. 23(a)(1) of non-business expenses when proximately related to the "conservation" of property held for the production of income. In *Sorgievsky* v. *McVitty*, 135 F. S. 233, 237, footnote 7, the following comment illuminates the point:

> "The *pari materia* rule of the Bingham decision has suggested the rather frequent analysis of first ascertaining whether an expense would be deductible had it resulted from a business transaction. If so, it is then held that the expense is deductible as a nonbusiness expenditure, inasmuch as all other requirements are substantially identical in construing §§ 23(a)(1) and 23(a)(2). The Supreme Court itself used this analysis in the Bingham case."

It is also important to observe that in *Kornhauser* as in the case at bar (Pet. Br. p. 54 et seq.), it was contended by the government (276 U.S., footnote p. 147, 48 S. Ct. 219, 220), that the expenses were incurred in defense of an accounting suit for the purpose of protecting property and that they were capital expenses. As previously stated, the Court of Claims, which sustained the government's theory was reversed. (See *Rossiafoss* v. *Commissioner*, *supra*.)

V. Petitioner's contentions (Pet. Br. pp. 51, 52, 53) notwithstanding, the Court of Claims in its findings of fact concluded that the misconduct charges had a direct bearing on the issue of whether the increase in value of the stock was community property. Finding 23 (R. 132):

> "(b) The credibility of the parties became an important factor in the evaluation by the trial court of the entire case, including both the misconduct and community property issues. Don Gilmore's attorneys feared that if the trial judge believed Dixie's charges, he might also find that there was community property and award all or most of it to her.
>
> "(c) There was an issue as to whether oral declarations and conduct between the parties had affected the nature of the property in dispute."

Finding 29 (R. 136):

> "None of the three attorneys who represented Don Gilmore kept records in which he undertook to allocate what percentage of his time or efforts was devoted to each of the several issues involved in the divorce litigation. However, each of them testified that more than 80 percent of the legal services which they rendered and for which they were paid by Don Gilmore in 1953 and 1954 were directed toward preserving his stock in the three dealerships as his separate property and in defeating Dixie Gilmore's claim that she was entitled to one-half of the increment in the value of that stock that occurred during the marriage."

In consideration petitioner's theory, viz: that the legal expense of respondent in respect to the deter-mi-

nation that none of the increment in value of the stock was community property be reallocated and treated as a non-deductible capital expense, it must be remembered that aside from the fact that the court below already made a final allocation (R. 137, F. 30), the controversy between respondent and his wife over what was and what was not community property partook of an accounting suit between marital partners. (See R. 133, F. 21; R. 135, F. 28(b); R. 131, F. 20(c).) The case authorities in this area reject the theory that legal expenses in defense of claims by partners in an accounting must be capitalized. The conflict is not over title to property; it is more in the nature of rights to and results of participation in earnings and the division, if any, to be made between the parties. See *Kornhauser* v. *U.S.*, *supra*, *Rassenfoss* v. *Commissioner*, *supra*, and *Sergievsky* v. *McNamara*, *supra*.

---

## CONCLUSION

For the reasons given in respondent's briefs, the judgment of the Court of Claims should be affirmed.

Dated, San Francisco, California,
November 14, 1962.

Respectfully submitted,

ELI FARHI,
*Attorney for Respondent*
*Dan Gilmore*.